
HOMEBUYERS AS FINANCIAL CREDITORS: NAVIGATING THE RERA-IBC CONFLICT

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ABSTRACT:

The enactment of the Insolvency and Bankruptcy Code (IBC) in 2016 aimed at expediting the resolution of insolvency cases introduced a significant paradigm shift. Notably, in 2018, consequential amendments extended financial creditor status to homebuyers under the IBC, enabling them to initiate insolvency proceedings against defaulting real estate developers. However, this commendable move has introduced complexities, particularly in its interplay with the Real Estate (Regulation and Development) Act (RERA), designed to safeguard the interests of homebuyers.

Homebuyers, now classified as financial creditors, encounter distinct challenges within the insolvency resolution process (CIRP). Their divergence in priorities, often prioritizing liquidation over corporate revival, disrupts the stipulated 180-day resolution timeline and adversely affects overall recovery rates.

The concurrent application of RERA and IBC poses intricate challenges. Opting for IBC procedures triggers a moratorium under Section 14, thereby suspending RERA petitions against the corporate debtor. Additionally, representation hurdles within the Committee of Creditors (CoC) impede effective participation by homebuyers.

Potential remedies include the integration of a conciliation mechanism within the ambit of RERA and the standardization of builder-buyer agreements. Proposed amendments by the Ministry of Corporate Affairs advocate for a specialized, project-centric resolution framework.

Harmonizing the competing priorities of RERA and IBC is imperative, necessitating legal amendments to achieve a balanced equilibrium. Ongoing legal and regulatory evolution remains pivotal to establishing a transparent, equitable system that safeguards homebuyers' rights and engenders stability within the real estate sector.

The Insolvency and Bankruptcy Code, 2016 (IBC) primarily exists to provide a time-bound and efficient process for resolving insolvency and

bankruptcy in a transparent manner. It was brought into force soon after the enactment of the Real Estate (Regulation and Development) Act, 2016 (RERA), which envisions the standardisation of business practices and transactions and effective consumer protection in the real estate sector.

In 2018, the Union Cabinet approved amendments to the IBC giving homebuyers the status of “financial creditors” in the insolvency process under the Code. In doing so, the Union Cabinet has overlooked the RERA – a special legislation to protect the interests of homebuyers. This has led to a conflict between the laws, and has left homebuyers with a myriad of remedies.

An insight into the Insolvency and Bankruptcy Code 2016

The National Company Law Tribunal was primarily established to adjudicate disputes related to companies, arising both under the Companies Act and the IBC. Under the Code, a class of creditors (financial creditors) can move an Insolvency Application under section 7 against the defaulting companies to initiate Corporate Insolvency Resolution Process (CIRP).

A financial creditor plays an important role in the corporate insolvency process, as the Committee of Creditors (CoC) includes all financial creditors of a corporate debtor. The CoC is empowered to appoint and supervise the Insolvency Professional, and has the power to approve or reject the resolution plan to revive the debtor, or can proceed to liquidate the debtor. The corporate insolvency process is time-bound and must be completed within 180 days.

The CIRP involves the crucial task of formulating a resolution plan to revive the company. Speed is of the essence for the working of the IBC as delay causes value destruction of assets under liquidation. The identification and removal of the sources of delay will result in a high recovery rate. Financial creditors largely consist of financial institutions and banks, and these bodies have the requisite expertise to actively participate in and contribute to the resolution process.

Liquidation is considered to be the last resort under the IBC. The best return is always achieved by rescuing the company as a going concern, apart from the fact that there are many jobs and livelihoods at stake. By keeping the company alive, the business can continue its operations and generation of revenue for the creditors. Alternatively, it can be sold as a going concern, resulting in a higher realizable value than the liquidated assets of the company.

Homebuyers to be treated as financial creditors under the Code

Prior to 2018, homebuyers were not accorded the status of creditors. The IBC did not have any specific provision dealing with the rights of allottees of real estate projects at the time of its enactment. In light of judicial pronouncements that correlated customer advances to the commercial effect of borrowing, the Code was amended to include allottees as 'financial creditors'.

By virtue of the amendment, homebuyers were entitled to initiate a CIRP against a defaulting real estate developer. They were also empowered to participate in the CoC of such developer. Subsequently, the IBC was further amended to specify a threshold for allottees to initiate action, with an objective of limiting frivolous applications.

Challenges accompanying the amendment

It is in the best interest of creditors of all classes to keep the real estate firm afloat through a resolution plan, instead of opting for liquidation. However, homebuyers will have little interest in the revival of the company or the corresponding macro-economic implications. Their end goal will be to recover their hard-earned money through the liquidation of the company's assets.

In India, almost all the companies that enter into the insolvency resolution process end up in liquidation. The inclusion of homebuyers as financial creditors will lead to unnecessary delay in the corporate liquidation process, which in turn will significantly reduce the value of the assets under liquidation and thereby reducing the recovery rate for all creditors.

Another challenge that has arisen is with respect to the representation of home-buyers. Difficulties are envisioned in obtaining consensus or a majority vote on various issues that are required to be addressed at the CoC meetings.

On the interplay between RERA and the Code, if a homebuyer opts to use provisions under the IBC and the National Company Law Tribunal orders a moratorium under Section 14, all pending petitions against the corporate debtor under RERA will be paused. Even if a section of home-buyers chooses to be governed by RERA provisions over the IBC, they will have no remedy available, or will be forced to proceed under the IBC.

As most real estate projects are funded by lenders, it may not be feasible for the association of allottees or the RERA authorities to take over the development when the entity might be taken to IBC.

The way forward

A potential solution under RERA that could improve the outcome for homebuyers is the adoption of a conciliation mechanism by all RERA authorities. These authorities are empowered under the Act to facilitate amicable conciliation of disputes between developers and allottees. Presently, such conciliation forums have been set up only in a limited number of states. This forum would serve as an alternative for dispute resolution in an efficient and cost-effective manner, while helping to alleviate the burden on RERA authorities.

The introduction of a uniform model builder-buyer agreement to be followed in all states is another potential solution that is pending consideration before the Supreme Court. This model agreement would prevent builders from inserting unfavourable 'contracting out' clauses in the agreement.

While attempting to formulate an effective resolution mechanism under the IBC, it is important to consider the nuances of the real estate sector. Homebuyers as a class of financial creditors are heterogenous and the most numerous. Unlike other financial creditors, homebuyers are more interested in the completion of the project and possession of their property rather than the maximization of recovery.

If an entity houses multiple projects, there is a possibility that only one or some of the projects are stressed. In such cases, a project-wise CIRP ensures minimum disruption to the other ongoing projects.

The proposed amendments by the Ministry of Corporate Affairs seek to provide a specialized resolution framework for real estate projects, where project-wise resolution will be permitted. It is also proposed that the Resolution Professional will have the power to transfer ownership and possession of the completed units to the allottees during the moratorium, with the consent of the CoC.

The inherent conflict between RERA and IBC in determining the priority of claims and the resolution process for the benefits of homebuyers is still a critical issue. There is a complex challenge posed by the need to strike a balance between the protection of homebuyers' rights, ensuring project completion, and the rights of other stakeholders.

It is imperative to create a harmonious and collective approach between the two legislations, potentially through judicial precedents or legal amendments. The priority of this collaboration

should be to streamline the resolution process, to prioritize the rights of homebuyers, and to ensure a fair and efficient mechanism to protect their financial interests and uphold the broader objectives of RERA and IBC.

Conclusion

The journey to solidify the position of homebuyers as financial creditors has been a significant stride in enhancing their protection and participation in the insolvency resolution process. Nonetheless, resolving the conflicts between RERA and IBC to establish a coherent framework that safeguards the rights of homebuyers while maintaining the balance of interests among stakeholders is an ongoing process that requires continued legal and regulatory evolution. It is vital to ensure a robust, transparent, and equitable system that secures the rights and investments of homebuyers, thereby fostering trust and stability in the real estate sector.