IBC should be home buyers’ last resort

They should approach the real estate regulator first as Rera contains more beneficial provisions for them

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The Supreme Court recently upheld the status of home buyers as financial creditors under the Insolvency and Bankruptcy Code (IBC). The judgment means that home buyers will be treated at par with other creditors and can draw legislatures to the National Company Law Tribunal (NCLT) if the latter defaults. Also, if lenders initiate recovery proceedings against a developer, property buyers will have a say in the resolution process.

The apex court’s decision does empower home buyers. It gives them an additional avenue to seek relief. But taking a developer to the NCLT may not always be the best decision. “Proceedings under IBC should be the last resort for property buyers. When a case goes to the NCLT, all creditors join the proceedings. There may be a risk for home buyers. The Real Estate (Regulation and Development) Act (Rera), on the other hand, gives more rights to home buyers. Resolution is also likely to be faster,” says Mukesh Jain, founder, Mukesh Jain and Associates, a law firm. Jain says if the company is solvent, even approaching a consumer court is a better option.

Lawyers say NCLT proceedings can also be complicated. At present, there are no precedents under the IBC for such cases.

Rera better for dealing with errant developers: Lawyers such as Rera are specifically designed to resolve property buyers’ problems. Lawyers point out that the real estate regulator in Uttar Pradesh has taken over projects to complete them. In Telangana, the state regulator has released guidelines that allow home buyers to remove the developer in case of delays. If most of the owners agree, they can even develop the project themselves.

In Mumbai, the members of Orbit Terraces Co-operative Housing Society approached the high court to take over their project. The buyers even reached a settlement with the consortium of lenders which had not proceeded to liquidate the company. Lawyers say that if such cases are tried under IBC, home buyers would get a fraction of the money they had paid to buy the house.

Not yet a settled law: The IBC is new and is still evolving. Many of its provisions are being challenged and are in the process of getting settled. The three key stakeholders in IBC proceedings are secured lenders like banks, home buyers and operational creditors (suppliers to whom money is owed). Of these, home buyers and secured lenders are considered to be financial creditors, and both have different objectives. Lenders want recovery of their loans while home buyers wish for completion of the project and to get possession of their home. “It still remains to be seen where the two would find common ground — a resolution that would satisfy both,” says Babu Sivaraprasad, partner, Economic Laws Practice. Some lawyers say there’s also little clarity on whether home buyers are secured or unsecured creditors. Others say the interpretation from the SC judgment is that property purchasers are unsecured creditors. In case of liquidation, unsecured creditors are placed below secured lenders, labourers and employees.

Under the IBC, the voting power of the members of the Committee of Creditors (CoC) is determined by the amount of debt owed to them. For example, one may own 1,000 crore. The home buyers’ interest may amount to 400 crore. If a resolution is proposed to the CoC, it needs 66.67 percent votes in favour to pass. The banks to whom 1,000 crore is owed would represent 71 percent of the votes. In such a case, if the banks accept the proposal, the home buyers may not get a say. Lawyers, therefore, say IBC makes sense only after buyers have exhausted all other avenues for relief.

Subsidiaries pose problems: Typically, developers form either a special purpose vehicle (SPV) or a subsidiary when executing a project. Banks lend to the subsidiary. In case of default, the SPV or subsidiary becomes insolvent. The parent organisation, therefore, cannot be taken to the NCLT. The only consolation is that the banks would have taken personal guarantees from the promoters, which can be liquidated. “But if the subsidiary is insolvent, then the parent company still has money, the home buyers cannot recover money from the parent company as it is an independent entity. Only if the buyers can establish that there has been diversion of funds from the SPV to the parent can they approach the court to involve the parent in the proceedings,” says Jain.

Delay is performance default: Home buyers can initiate IBC proceedings against a developer only if there has been a financial default. Delays are performance defaults. Home buyers will need to convert the delay into a monetary default. “They can do so by asking the developer to cancel their booking and pay back their money with interest. If the developer fails to do so, and the default amount is over 1 lakh, the buyer can initiate IBC proceedings,” says Mohit Chaudhary, managing partner, Kings & Alliance LLP. Financial default can also happen if a developer mentions in the contract that it will compensate home buyers in case of delays but fails to do so within the stated timeline.

Unite to fight: When secured lenders initiate bankruptcy proceedings against a developer, home buyers need to organise themselves to ensure they get their dues. When a case goes to the NCLT, an intervener in resolution professional is appointed, and a CoC is formed, which takes most decisions. The resolution professional will appoint an insolvency professional, who will represent all the homebuyers in the CoC. Home buyers have to bear the fees paid to this expert. When bidders submit their tendering plans for the project, the insolvency professional must discuss them with the home buyers and take a vote on whether they agree to the offer. A higher number of purchasers coming to vote will ensure an outcome that suits them.

Finally, both IBC and Rera have clauses which says it will prevail in case of conflict. Under another law. The law is that, in case where the IBC conflicts with Rera, the former will prevail.

WHY RERA MAKES SENSE

- No lawyer needed for representation
- Procedures are easy
- A single home buyer can approach the authority
- Investors can also seek relief
- Only buyers are part of the proceedings
- Some regulators have started taking over projects and are allowing buyers to finish them

“The objectives of lenders and home buyers are entirely different. It remains to be seen where the two will find common ground.”

BABU SIVAPRASAD
Partner, Economic Laws Practice

“When a case goes to the IBC, all creditors join the proceedings, which may leave little for home buyers. Rera offers them better and faster resolution”

Mukesh Jain
Founder, Mukesh Jain and Associates