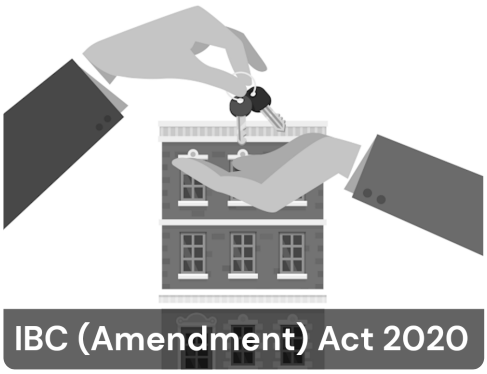
IBC (Amendment) Act 2020 : Yet Another Obstacle For Homebuyers?



The Insolvency and Bankruptcy Code (Amendment) Act, 2020 ("**Amendment**") was enacted on 13 March 2020, replacing an Ordinance (to the same effect) which came into effect on 28 December 2019. The Amendment *inter alia* introduces a minimum threshold for initiation of proceedings by certain categories of financial creditors, most significantly homebuyers (allottees), by prescribing that Section 7[1] of the Insolvency and Bankruptcy Code, 2016 ("**Code**") can be triggered only on an application filed jointly by atleast 100 allottees or 10% of the total allottees under the same real estate project, whichever is lesser.

Background- Initial Relief to Allottees

In our previous newsletter, we discussed the Insolvency and Bankruptcy Code (Second Amendment Act), 2018 ("**the 2018 Amendment**") which gave allottees, as defined under the Real Estate Regulation and Development Act, 2016 ("**RERA**"), the same rights as financial creditors under the Code.[2]

Subsequently, in *Pioneer Urban Land and Infrastructure Ltd. v. Union of India*[3] *("***Pioneer***")*, the Supreme Court ("**SC**") upheld the constitutionality of the 2018 Amendment and rejected a challenge brought by a group of developers. The SC clarified that allottees were always included within the ambit of the Code

Section 7 of the Code can be triggered only on an application filed jointly by atleast 100 allottees or 10% of the total allottees under the same real estate project.

from its inception, and the 2018 Amendment was merely clarificatory in nature.

The IBC Amendment Act, 2020

The Amendment *inter alia* introduces three provisos to Section 7 of the Code. The second and third provisos deal with rights of allottees to trigger the insolvency process as financial creditors against a developer under the Code.

The Second Proviso- Introduction of Minimum Limit

The second proviso provides that in the case of financial creditors who are allottees under a real estate project, an application for triggering insolvency process shall be filed jointly by not less than one hundred of such allottees or ten percent of the total allottees under the same real estate project, whichever is lesser.

Is it discriminatory?

There are serious apprehensions about the constitutionality of the minimum limit introduced by the second proviso. The SC in *Pioneer* clarified that allottees, as defined under RERA, are placed on the same footing as any other financial creditor from the inception of the Code. Interestingly, in *Pioneer*, the SC had also rejected the contention of the developers that there should be a threshold limit of at least 25% of the total number of allottees of a project before they could trigger the Code.

In light of the above, the Amendment, by introducing the minimum requirement in respect of allottees, may be viewed as discriminatory and in breach of Article 14 of the Constitution of India[4].

> **Pending any decision/clarification from the Supreme Court allottees will now have to examine the options available to them to move against a defaulting developer.**

A group of Petitions filed by allottees have challenged the constitutional validity of the Ordinance dated 28 December 2019 before the SC. While the matter is still pending adjudication, the SC, on 13 January 2020, ordered that *status quo* be maintained in respect of the pending applications filed by allottees.[5] On the basis of this Order, several allottees and associations have approached the SC and obtained a similar stay on pending applications under Section 7 filed by them.

Practical Concerns for Allottees

Apart from the questions relating to its constitutionality, the second proviso has given rise to the following practical difficulties that may be faced by bona-fide allottees seeking to invoke the provisions of the Code.

- It is unclear how an allottee is expected to ascertain how many units have been sold by the developer and/or to place and contact the remaining allottees of the real estate project. A convenient mechanism or database for allottees to access this information ought to be prescribed.

- Different allottees of a given project may be inclined to pursue different legal routes (for instance, some may choose to proceed under the RERA or Consumer Protection Act; similarly, some may seek possession, while others may seek a refund). This would make it difficult for the allottees wishing to proceed under the Code to meet the minimum 10 percent requirement, rendering them remediless under the Code, and they may be compelled to look at alternate remedies.
  Interestingly, the SC in *Pioneer* has clarified that the remedies of a homebuyer under the Code, RERA and Consumer Protection Act are concurrent. It has further clarified that in case of inconsistency, the Code would prevail over RERA. The Amendment effectively nullifies the said observation of the SC, by making it significantly more difficult for a homebuyer to invoke the provisions of the Code.

- Another ambiguity may arise in a situation where an Application is filed by the requisite minimum number of allottees, and subsequently the developer settles with a few of such allottees, who then withdraw from the proceedings. It is unclear whether the application will fail automatically if the number then falls below the prescribed minimum limit.

Right of individual allottees to submit Claims with IRP remains unaffected

Notably, the Amendment Act does not prevent allottees or associations (who do not meet the minimum criteria under the proviso) from submitting a claim with the Insolvency Resolution Professional under Section 15 of the Code. This would only arise in a situation when another application for initiation of insolvency resolution process against a defaulting developer has been admitted by the National Company Law Tribunal.

The Third Proviso- Pending Applications by Allottees

The third proviso accounts for pending applications already filed by allottees, and provides that where such application is still pending admission, it shall be modified to comply with the requirements of the second proviso within thirty days of 28 December 2019, failing which the application shall be deemed to be withdrawn.

Retrospective Effect

The third proviso therefore provides for retrospective application of the Amendments introduced to Section 7. This will cause several pending applications, towards which considerable time and money has already been spent by allottees, but which do not comply with the new minimum requirement to fail.

The period of thirty days for the compliance has now expired. However, as stated above, in *Manish Kumar*, the SC has granted a stay on certain pending applications filed by allottees

Intent of the Parliament

In a parliamentary debate, the Finance Minister sought to justify the intent behind the Amendment and the introduction of the minimum threshold explaining that it was a mechanism to prevent frivolous litigation by allottees. As per data provided by the Lok Sabha, a total of 1821 cases were filed by allottees with the respective National Company Law Tribunals from up to 30 September 2019.[6] While the intent is justified (given the burden already being faced by the National Company Law Tribunals across the nation) whether it validates a blanket restriction which curbs the rights of an entire class of financial creditors is questionable. Notably, the increase in litigation on account of allottees being given the status of financial creditors was anticipated by the SC, in *Pioneer* wherein it observed that *"it is absolutely necessary that the NCLT and the NCLAT are manned with sufficient members to deal with litigation that may arise under the Code generally, and from the real estate sector in particular*."

Conclusion- Implications of the Amendment

In light of the Amendment, and pending any decision/clarification from the SC in *Manish Kumar* as to the constitutionality of the same, allottees will now have to examine the options available to them to move against a defaulting developer. Where an application for initiation of CIRP proceedings against the developer has already been admitted, the allottee/s may file a claim with the Interim Resolution Professional.

In all other cases, an allottee seeking to invoke the Code will now have to meet the minimum threshold requirement of 100 allottees or 10% allottees, whichever is lesser. Those allottees, who find themselves unable to take advantage of the Code on account of the practical difficulties introduced by the recent Amendment, may consider pursuing remedies under RERA and the Consumer Protection Act, 1986.

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[1] Section 7 of the Code pertains to Initiation of Corporate Insolvency Resolution Process by Financial Creditors.
[2] http://www.hariani.co.in/view_newsletter.php?id=71
[3] 2019 SCC Online SC 1005
[4] Article 14 states that the State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India.
[5] Manish Kumar & Ors. v. Union of India, Writ Petition (Civil) 26 of 2020, https://main.sci.gov.in/supremecourt/2020/583/583_2020_4_23_19446_Order_13-Jan-2020.pdf
[6] Ministry of Corporate Affairs, Lok Sabha, Un-starred Question No. 32, available at http://164.100.24.220/loksabhaquestions/qhindi/172/AU32.pdf