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Homebuyers under the insolvency and bankruptcy code: From consumers to financial creditors.

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Abstract

The provision of recognizing home buyers as financial creditors within the ambit of the Insolvency and Bankruptcy code (IBC) 2016 is considered as one of the most important milestones within the Indian Insolvency law framework. Prior to this framework, homebuyers primarily relied only on the Consumer Protection Act and Real Estate Regulation and development Act 2016 (RERA), which provided limited safeguards and redressal to real estate developers who entered insolvency proceedings. However, this approach was completely overhauled by the insolvency and bankruptcy code (Second Amendment) 2018, which gave home buyers the status of financial creditors by defining "financial debt" under section 5(8)(f) to include money obtained from the allottees in respect of any real estate development projects. As a result, of this legal change, they were permitted to participate in the committee of creditors through authorised representatives, initiate the insolvency proceedings, and influence decisions pertaining to the resolution of distressed real estate companies.

This article examines the legal and judicial development of homebuyer's rights under the Insolvency and bankruptcy code, through an analysis of the rationale behind the reclassification and the implications of this transformation. It analyses key statutory provisions and significant judicial pronouncements, including Pioneer Urban Land and Infrastructure Ltd vs. Union of India, which has shaped the contours of homebuyer's rights within the insolvency regime. Moreover, this article evaluates the practical impact of these reforms, emphasizing on the enhanced protection afforded to homebuyers while addressing continuing challenges such as delay in resolution, conflicts among stakeholders, and potential misuse of *insolvency proceedings. In conclusion, the article analyses the effectiveness of the current legislation and reforms that may strengthen the position of homebuyers.*

Keywords: Insolvency proceedings, homebuyers, rights, financial creditors and consumers

Historical background

The enactment of the Insolvency and bankruptcy code, 2016 (IBC) marked a transformative moment in India's insolvency regime as it introduced a consolidated and creditor-led mechanism to address issues pertaining to corporate insolvency.[1] Prior to IBC, insolvency proceedings were governed by multiple statutes, including the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Recovery of Debts and Bankruptcy Act,1993 and companies Act 2013. The overlapping of different legal mechanisms often resulted in prolonged litigation, inconsistent outcomes and low recovery rates. Understanding the limitations of this system, the Bankruptcy Law Reforms Committee suggested formulating an insolvency law structure that would facilitate time-bound resolution, maximise the value of distressed assets, and ensure the interests of all stakeholders.[2] These recommendations ultimately led to the enactment of Insolvency and Bankruptcy code 2016.

In the case *Swiss Ribbons Pvt. Ltd. & Anr. v. UOI & Ors,* the Supreme court of India has upheld the constitutional validity of Insolvency and Bankruptcy code 2016, observing that the code has substantially helped in improving the insolvency mechanism by ensuring quick debt resolution and facilitating the flow of financial resources.[3]

Although the IBC represented a substantial reform in insolvency law, its initial framework did not adequately address the interests of homebuyers in the real estate sector. The code recognised only financial creditors and operational creditors as principal stakeholders in the corporate insolvency resolution process (CIRP), leaving homebuyers outside both categories.[4] Despite investing substantial sums in under- construction projects and effectively financing real estate developments through advance payments, homebuyers lacked the legal standing to initiate insolvency proceedings or participate in committee of creditor (COC). The only relief available to homebuyers was the Consumer Forums and the Reall Estate Regulation and

[1] Insolvency and Bankruptcy Code, No. 31 of 2016, India Code (2016)
[2] Bankruptcy Law Reforms Committee, The Report of the Bankruptcy Law Reforms Committee: Volume I Rationale and Design (Nov. 2015).
[3] Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 S.C.C. 17
[4] Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 5(7), 5(20), India Code (2016).

Development Act,2016 (RERA).[5] However, these remedies were not always effective as when the developers become insolvent the homebuyers had little influence over the insolvency process and frequently ranked behind institutional lender in the recovery of assets.

The increasing number of stalled housing projects and insolvency proceedings involving major real estate developers pointed out this legislative gap, prompting calls for reform. A significant milestone was achieved through the Insolvency and Bankruptcy code (Second Amendment) Act, 2018, which amended Section 5(8)(f) to recognise amounts raised from allotees under real estate projects as "Financial debt." [6] Thus, the homebuyers were granted the status of financial creditors, enabling them to initiate insolvency proceedings under Section 7 of the IBC, participate in the COC through authorised representatives, and exercise voting rights on resolution plans.[7]

Existing law and present legal position

The present legal framework governing homebuyers are principally derived from the combined operation of Insolvency and Bankruptcy code,2016 and the Real Estate Regulation and Development Act 2016. While RERA continues to regulate the obligations of promoters and safeguard consumer interests, the IBC provides a collective mechanism for resolving insolvency where the financial viability of the developer is in question. The homebuyers are now treated as financial creditor according to IBC and are represented by an approved representative who casts vote on behalf of the class of allottees in the Committee of Creditors. In projects with hundreds or even thousands of buyers, this collective representation aims to strike a compromise between efficiency and participatory rights.Nevertheless, the practical difficulties do not end here. Homebuyers often have divergent interests some seek possession of their homes, whereas others would prefer a refund of their investments. In addition, financial institutions typically possess greater bargaining power in insolvency proceedings, another reason that concerns the interests of homebuyers during negotiations on resolution plans.

Another important reform came through the Insolvency and Bankruptcy code (Amendment) 2020, which introduced a minimum threshold for initiating a CIRP by homebuyers. As per the amended section 7 of the IBC, an application must be jointly filed by at least 100 allotees or

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[5] Real Estate (Regulation and Development) Act, No. 16 of 2016, India Code (2016); Consumer Protection Act, No. 35 of 2019, India Code (2019).
[6] Insolvency and Bankruptcy Code (Second Amendment) Act, No. 26 of 2018, § 3, India Code (2018).
[7] Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 5(8)(f), 7, 21(6A), India Code (2016).

10% of the total allottees of a project, whichever is lower.[8] The aim behind the introduction of the threshold or amendment was to ensure that no baseless or coercive application is made during insolvency and at the same time ensuring that insolvency can only be initiated in case of genuine grievance. The amendment has also been criticized for making access to the insolvency process more difficult for individual homebuyers.

Judicial Interpretation Strengthening the Position of Homebuyers

The judiciary has played a decisive role in shaping the rights of homebuyers under the IBC

Pioneer Urban Land and Infrastructure Ltd vs. Union of India (2019)

The case of Pioneer Urban Land and Infrastructure Ltd vs. Union of India is a landmark judgment that affirmed the legislative recognition of homebuyers as financial creditors under Insolvency and Bankruptcy code, 2016.[9]

Facts of the case: The Insolvency and Bankruptcy code (Second Amendment) Act, 2018 amended section 5(8)(f) of the Insolvency and Bankruptcy code, 2016 to include amounts raised from allottees under real estate projects within the definition of "financial debt," thereby granting homebuyers the status of financial creditors.[10]

Aggrieved by this amendment, Pioneer Urban Land and Infrastructure Ltd. And other real estate developers filed writ petitions before the Supreme Court challenging its constitutional validity. It was held by the petitioners that the homebuyers were essentially consumers purchasing residential units and could not be equated with banks or financial institutions.[11] They further contended that labelling homebuyers as financial creditors would expose developers to insolvency proceedings even in cases involving minor disputes or delays and could be misused as a debt recovery mechanism. The real estate industry also claimed that the legislation applicable to the problems of the allottees is Real Estate Regulation and Development Act, 2016 (RERA) and that allowing allottees to initiate IBC proceedings would bring down the entire real estate sector.

Issue before the court:

[8] Insolvency and Bankruptcy Code (Amendment) Act, No. 1 of 2020, India Code (2020).
[9] *Pioneer Urban Land & Infrastructure Ltd. v. Union of India*, (2019) 8 S.C.C. 416.
[10] Insolvency and Bankruptcy Code (Second Amendment) Act, No. 26 of 2018, § 3, India Code (2018);
[11] *Pioneer Urban Land & Infrastructure Ltd.*, (2019) 8 S.C.C. 416.

- Whether the Insolvency and Bankruptcy code (Second Amendment) Act, 2018, which recognised homebuyers (allottees) as financial creditors under Section 5(8)(f) of the Insolvency and Bankruptcy Code,2016, was constitutionally valid?
- Whether amounts raised from the homebuyers for real estate projects constitute as "financial debt"?
- Whether treating homebuyers as financial creditors violated Article 14 of the constitution by creating arbitrary or unreasonable classification?
- Whether permitting homebuyers to initiate the Corporate Insolvency Resolution process (CIRP) under section 7 of the IBC would result in misuse of the insolvency mechanism as a means of debt recovery rather than corporate insolvency resolution?

Decision by the Supreme Court: The Supreme Court of India upheld the constitutional validity of the Insolvency and Bankruptcy code (Second Amendment) Act, 2018, and dismissed the challenges raised by the real estate developers. The court held that amounts paid by homebuyers to developers constitute financial debt under Section 5(8)(f) of the Insolvency and Bankruptcy code, 2016, as such advances have the commercial effect of borrowing and are used by developers to finance real estate projects.

The court further rules that recognising homebuyers as financial creditors does not violate Article 14 of the Constitution[12], as the classification is based on an intelligible differentia and has a rational nexus with the objective of protecting stakeholders who invest in real estate projects. Additionally, the Supreme Court clarified that homebuyers have the right to initiate Corporate Insolvency Resolution process (CIRP) under section 7 of the IBC, the code is not intended to serve as a debt recovery mechanism. Insolvency proceedings shall be initiated only when there is a real default, and the Adjudicating Authority may reject applications filed with malicious or fraudulent intent.

Chitra Sharma vs. Union of India (2018)

The case is based on the insolvency of Jaypee Infratech Limited, which is one of the biggest real estate companies in India. Many homebuyers had invested in residential projects but faced prolonged delays in the delivery of the possession despite making substantial payments. On the other hand, Jaypee Infratech defaulted on loans owed to its financial creditors, leading to the initiation of the corporate Insolvency Resolution Process (CIRP) under the Insolvency and

[12] INDIA CONST. art. 14; *Pioneer Urban Land & Infrastructure Ltd.*, (2019) 8 S.C.C. 416.

bankruptcy Code, 2016. Since homebuyers were not recognised as financial creditors under the Insolvency and Bankruptcy Code,2016, they had no representation in the committee of creditors (COC) and were unable to participate in decisions concerning the resolution of the company.[13] Aggrieved by the possibility of losing both their homes and investments, a group of homebuyers led by Chitra Sharma approached the Supreme Court seeking protection of their interests and challenging their exclusion from the insolvency resolution process.

The Supreme Court stressed on the importance of safeguarding the interest of homebuyers and passed the decision that the interest of the homebuyers shall be considered during insolvency proceedings. Although the case was decided before the 2018 amendment, it highlighted the importance of current legislation and significantly influenced the legislative decision to recognise homebuyers as financial creditors.[14] This judgment has been considered as a landmark in the development of homebuyers' rights within the Indian in insolvency regime.

Recommendations

Although the current framework provides greater protection to homebuyers than before, certain reforms could further strengthen their position while preserving the objectives of the IBC.

Firstly, the need for more coordination of the laws between Insolvency and Bankruptcy Code and Real Estate (Regulation and Development) Act, 2016, is required so that any conflicts within the jurisdiction may be avoided and the claims of homebuyers may be treated in a uniform way.

Secondly, resolution plans involving real estate projects should prioritize the completion of housing projects and to consider a detailed guidelines regarding the role and responsibilities of authorized representatives to ensure effective communication between homebuyers and the Committee of creditors. Improved transparency and regular dissemination of information would enable homebuyers to participate more meaningfully in insolvency proceedings.

Lastly monitoring of developers' utilisation funds, greater compliance with RERA and timely implementation of approved resolution plans would reduce the likelihood of project failures and minimise the need for insolvency proceedings. These measures would complement the

[13] Chitra Sharma v. Union of India, (2018) 18 S.C.C. 575.
[14] Id.

objectives of the IBC by promoting both consumer protection and financial discipline within the real estate sector.

Conclusion

The evolution of homebuyers from consumers to financial creditors under the Insolvency and Bankruptcy Code, 2016 represents one of the most significant reforms in India's insolvency framework. By recognising the financial contribution of allottees and granting them participation in the Corporate Insolvency Resolution Process, the legislature addressed a long-standing imbalance that had left homebuyers vulnerable during the insolvency of real estate developers. Judicial decisions have further strengthened this framework by affirming the constitutional validity of the amendments and emphasising that the primary objective of the IBC is corporate resolution rather than individual debt recovery.