EXCLUSIVE | Bankruptcy Code: Are homebuyers secured financial creditors? Read builder agreement carefully

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The latest Ordinance on the Insolvency and Bankruptcy Code (IBC) has, for the first time, recognised home-buyers as financial creditors but whether they are secured or unsecured financial creditors hinges on the nature of their agreements with realty developers.

MS Sahoo, the chairman of the Insolvency and Bankruptcy Board of India that notified regulations for corporate resolution process last week, also says an insolvency case can be withdrawn from the NCLT with the approval of 90% of lenders only before any bidder/applicant submits his resolution plan.

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the number of bidders and balances the interests of various stakeholders, including home buyers and MSMEs.

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Q: The latest Ordinance on the Insolvency and Bankruptcy Code (IBC) has granted home buyers the status of financial creditors. But will they be secured financial creditors or unsecured ones?

The IBC defines a secured creditor to mean a creditor in favour of whom security interest is created. It recognises security interest and confers certain rights on secured creditors. It, however, does not create security interest, which is a matter of contractual relationship between a creditor and a borrower. Hence secured or unsecured tag is not a matter determined under the IBC.

Q: So, basically, the agreement between a homebuyer and his builder will decide his status of secured or unsecured financial creditor?

Yes. In any case, this (secured or unsecured) tagis material only when a corporate debtor gets into liquidation. At the stage of resolution, which the IBC promotes, a financial creditor, whether secured or unsecured, has the voting rights in proportion to his claim.

Q: How will home buyers be represented? How can they contribute to decision-making in the committee of creditors?

It's not just about home buyers but about large number of creditors in a class. There are certain classes which have a formal arrangement for their representation. For example, the debenture holders are represented by a debenture trustee. The regulations provide an arrangement for representation of creditors in other classes. Where the corporate debtor has at least ten creditors in a class, the interim resolution professional shall offer a choice of three insolvency professionals and a creditor in the class may indicate its choice of an insolvency professional, from amongst the three, to act as its authorised representative.

The insolvency professional, who is the choice of the highest number of creditors in the class, shall be appointed as the authorised representative of the creditors of the respective class. The authorised representative will collect voting instructions from creditors (allottees in real estate projects, fixed deposit holders, etc.), attend the meetings of the committee of creditors (CoC) and cast his vote in respect of each creditor in accordance with the instructions he has received.

Q: What happens when homebuyers of the same project are split-some in favour **and some against a resolution plan?**

Suppose there are 100 creditors in a class. Of them, 50 voted in favour of a proposal, 30 voted against, and 20 abstained from voting.The authorised representative shall cast positive votes for 50 creditors and negative votes for 30 creditors and not vote for the balance 20 creditors.

Q: So will homebuyers' voting right (in percentage term) be in sync with their advances?

The voting right is in proportion to the amount of financial debt of a creditor. The debt usually includes the principal as well as the interest. Where rate of interest has not been agreed to between the parties in case of creditors in a class, the voting share of such a creditor shall be in proportion to the financial debt that includes an interest at the rate of eight per cent per annum.

Q: Will the new provisions of the IBC be applicable **prospectively or retrospectively?**

Usually, the law has prospective effect unless stated otherwise.

Q: What does the government want to convey through this Ordinance?

The Ordinance very explicitly states the objectives. Firstly, it promotes resolution over liquidation. For realisation of this objective, the

Ordinance reduces voting threshold from 75% to 66% for approval of a resolution plan by the CoC; streamlines provisions relating to eligibility of resolution applicants to make more resolution applicant eligible; provides one year from the date of approval of resolution plan for obtaining various approvals; etc. For instance, a person is ineligible if it has a non-performing asset (NPA) account. Now, a clean person comes in to rescue a stressed company which has an NPA account. On taking over the stressed company, the clean person inherits the NPA account and, therefore, becomes ineligible to submit resolution plans for other stressed companies.

The Ordinance allows that person a breather for three years to remedy the NPA account and, therefore, makes it eligible to submit resolution plans in the interim. Similarly, a pure play financial entity shall not be ineligible to submit resolution plans even if it is a related party of the corporate debtor, if the relationship is solely on account of conversion of debt to equity prior to insolvency commencement date. Secondly, the Ordinance balances the interests of various stakeholders such as home buyers and micro, small and medium enterprises.

Q: What happens if some other classes of debtors demand relief similar to that of defaulting MSME promoters?

We don't have another class as unique as MSMEs. Firstly, MSMEs as a class are very important for the economy. Secondly, an MSME is a debtor and a creditor simultaneously. It may not recover its dues as a creditor while it must honour its obligations as a debtor. Third, most of the MSMEs are proprietorship and partnership firms. While corporate MSMEs are dealt with under the corporate framework, proprietorship and partnership MSMEs are under the individual framework. Thus, insolvency resolution of MSMEs needs a framework which is somewhere between the two. That is why MSMEs are treated differently everywhere in the world.

Q: By when can we expect a framework on individual insolvency?

The endeavour is to start with the personal guarantors to corporate debtors, which complements the corporate insolvency framework and for which the Adjudicating Authority is the NCLT. The next would be proprietorship and partnership firms. We need to learn from the experience of these two before we embark on the entire mass.

Q: There is a provision that if 90% of lenders approve, a case can be withdrawn. At what stage will it be applicable?

Once a corporate insolvency resolution process (CIRP) is initiated, it is no more a lis between the applicant and the corporate debtor and hence they alone cannot close it.The Ordinance read with regulations now allow closure with a super-majority approval, that too, before the invitation of the expression of interest from prospective resolution applicants. Wherever an applicant applies to withdraw his application (closure of CIRP), theCoC shall consider the application within seven days of its constitution or seven days of receipt of the application, whichever is later. If the application is approved by the CoC with 90% voting share, the resolution professional shall submit the application to the Adjudicating Authority on behalf of the applicant, within three days of such approval.

Q: The home buyers will hardly get anything out of liquidation. Is there any exemption that can be granted whereby a stressed real estate company can't go for liquidation but only resolution?

One must balance rights vis-à-vis reality. The stakeholders need to share the pain or gain equitably. If the firm is not viable, resolution cannot be mandated. Liquidation can be avoided if the stakeholders start the process early before the cake shrinks and they close it expeditiously before the cake shrinks further. They also need to enlarge the cake during resolution by appropriate value enhancement. This requires the stakeholders to be extremely vigilant and business savvy.

Q: Can insolvency be initiated now for defaults that happened in very distant past?

There was a doubt whether an insolvency proceeding can be triggered for a default that happened at any time in the past. Now, the Ordinance makes it clear that the law of limitation applies.

Q: How does the IBC deal with cases where the promoters have siphoned off funds?

The resolution professional is obliged to form an opinion whether a firm has been subjected to certain transactions (preferential transactions, undervalued transactions, extortionate transactions or fraudulent transactions) by the 75th day and make a determination of the same by the 115th day, of the insolvency commencement date. Where the resolution professional makes such a determination, he shall apply to the Adjudicating Authority for appropriate relief before the 135th day of the insolvency commencement date.

Q: The Ordinance seems to have further strengthened the IBBI.

IBBI has been given a clear responsibility to promote the development of, and regulate the working and practices, of IPs, IPAs and IUs and other institutions in furtherance of the objective of the Code.

Q: How many insolvency cases have been admitted so far?

Nearly a thousand firms have been admitted, of which about 80 have been closed on review or appeal, about 150 have yielded resolution or regulation and the balance are ongoing.