‘Allottees’ as financial creditors: pushing the conceptual limits of the Indian insolvency regime

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‘Allottees’ as financial creditors: pushing the conceptual limits of the Indian insolvency regime

M P Ram Mohan* & Vishakha Raj**

Abstract

The Insolvency and Bankruptcy Code, 2016 (IBC) was amended in June 2018 to include amounts raised from an allottee (any person to whom an apartment or plot in a real estate project has been allotted or sold) in a real estate project within the definition of ‘financial debt’ thereby recognising allottees as financial creditors. Though the Supreme Court of India has upheld the constitutional validity of the amendment, its rationale raises concerns about the purpose of the Indian insolvency regime. Through the amendment, Parliament appears to have operationalised the insolvency regime to solve a sectoral problem, namely, mismanagement in the real estate sector. This paper posits that the amendment was enacted at the cost of stretching the definition of ‘financial creditor’ beyond its conceptual limit and interfering with the IBC’s insolvency resolution mechanism. It also examines the basis of the inclusion of allottees within the IBC and uses past decisions of the IBC’s adjudicating authorities as a reference for its analysis. The paper concludes that the reasons supporting the inclusion of allottees within the definition of a ‘financial creditor’ are less persuasive than those which favour its exclusion.

Keywords: Indian Insolvency and Bankruptcy Code; financial creditors; operational creditors; home buyers; allottees

JEL Codes: K1; K2; G2; G3

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Introduction

On 6th June, 2018, the Government of India amended the Insolvency and Bankruptcy Code, 2016 (IBC) through the Insolvency and Bankruptcy Code Amendment Ordinance, 2018. The Amendment Ordinance was permanently incorporated into the IBC through the Insolvency and Bankruptcy (Second Amendment) Act, 2018 (2018 Amendment) passed by Parliament on 17th August, 2018. The 2018 Amendment used a deeming fiction to bring ‘allottees’ within the scope of the definition of ‘financial creditor’. This was done by inserting an “Explanation” under clause (f) of sub-Section (8) of Section 5 which defines ‘financial debt’. The explanation deems moneys given by allottees to a builder/real estate developer to be amounts having the ‘commercial effect of a borrowing’. Since ‘financial creditors’ are defined to mean persons to whom a ‘financial debt’ is owed, the 2018 Amendment gives an allottee the status of a financial creditor under the IBC. Deeming fictions may have the effect of treating “an imaginary state of affairs as real”\(^1\) or they may take a milder form where they only serve to clarify what is uncertain but already implied within a provision of the law.\(^2\) Subsequent discussions in the paper will examine the nature of the deeming fiction used in the 2018 Amendment in light of the Supreme Court decision upholding it.\(^3\)

An ‘allottee’ has been defined under Section 2(d) of the Real Estate (Regulation and Development) Act, 2016 (RERA) as any person to whom an apartment or plot in a real estate project has been allotted or sold.\(^4\) An ‘apartment’ has been defined under Section 2(e) of RERA to mean a separate and self-contained part of any immovable property meant for commercial or residential use. An apartment, \textit{inter alia}, includes a shop, dwelling unit, office, and showroom. The 2018 Amendment was based on the Insolvency Law Committee’s Report of March 2018 (ILC report) which highlighted how real-estate projects in India were often delayed and that this was a sector-wide concern.\(^5\) The report noted that out of 782 real estate projects in India, 215 of them had undergone delays ranging from 1 month to 261 months.\(^6\) Allottees had attempted to trigger insolvency proceedings against their real-estate developers to remedy such delays. The insertion of the term ‘allottee’ as defined under RERA into the IBC

\(^2\) See, Pioneer, ¶ 84, 69; See also, St. Aubyn v. Attorney General (No. 2) (1952) AC 15.
\(^3\) See, Pioneer.
\(^4\) Real Estate (Regulation and Development) Act, No. 16 of 2016 § 2(d).
\(^5\) MINISTRY OF CORPORATE AFFAIRS, REPORT OF THE INSOLVENCY LAW COMMITTEE (March 2018) at 16
\(^6\) \textit{Id.}
was recommended by the ILC report to put them in a better position vis-à-vis the real estate developer.

The 2018 Amendment was challenged by real estate developers before the Supreme Court of India in *Pioneer Urban Land and Infrastructure Ltd. v. Union of India.*\(^7\) One of the grounds of the challenge was that ‘allottees’ and ‘other financial creditors’ did not belong to the same category, and that treating the two equally would violate Article 14 of the Constitution of India.\(^8\) The petitioners likened ‘allottees’ to ‘operational creditors’ (the second category of creditors under the IBC). When allottees are classified as ‘financial creditors’ instead of ‘operational creditors’ the real-estate developers lose valuable defences against them (these have been discussed in the next section). The petitioners also urged that allottees already had a sector-specific remedy under the RERA, which provides a mechanism for adjudicating disputes between the developer and allottees.

The Supreme Court, however concluded that the 2018 Amendment was constitutional. The Court acknowledged the existence of remedies under the RERA and held that these remedies, along with those available under the Consumer Protection Act, 1986 (which has been repealed by the Consumer Protection Act, 2019) were concurrent with remedies under the IBC. The Court stated, *inter alia,* that allottees were in a unique position, given that they essentially financed the construction of their own apartments. This formed the basis of the Supreme Court’s differentiation between home-buyers and other operational creditors, thus warranting that the former receive the status of financial creditor.

Before the *Pioneer* case and the 2018 Amendment, there were cases where the Adjudicating Authority under the IBC had to decide the position of allottees (mostly home-buyers)\(^9\) under the Indian insolvency regime. In some of these cases the Adjudicating Authority had come to the conclusion that home-buyers/allottees were financial creditors under the IBC. However, there were very specific circumstances in these cases which persuaded the IBC’s Adjudicating Authority that the allottees therein were financial creditors.

\(^7\) See, *Pioneer.*

\(^8\) Article 14 of the Indian Constitution enshrines the right of equality. The Supreme Court has also interpreted Article 14 to include the right against arbitrary treatment.

\(^9\) Most cases before the company law tribunals and the Supreme Court were brought by home-buyers i.e., those who has advanced money for the construction of residential flats.
While other jurisdictions such as the US, UK, and Australia have protected the interests of ‘allottees’ through laws which protect consumer pre-payments generally, India has taken a different approach. The 2018 Amendment not only protect allottees but also makes them a key stakeholder in the insolvency process of the real-estate developer. This paper critiques the Indian Government’s approach to protecting allottees. The paper’s critique has two parts. The first part examines a series of decisions of the Adjudicating Authority and the Supreme Court to contextualize IBC’s original definition of ‘financial debt’, and the implication of allottees’ categorization as financial creditors. The unique contribution of this paper to existing literature on the subject will be a comparative evaluation of the approaches of Adjudicating Authority and the Supreme Court (in Pioneer) to the treatment of allottees under the IBC. We find that the nuanced manner in which the Adjudicating Authority gave the status of ‘financial creditor’ to some allottees is more logically and conceptually consistent than the approach taken by the ILC report and the 2018 Amendment (as upheld and explained in the Pioneer case). The second part of the paper highlights some unforeseen consequences of the 2018 Amendment, especially in light of the precedent it sets for ‘who’ can trigger insolvency proceedings against a corporate debtor and participate in the reorganisation of its debt. We find that though the 2018 Amendment is quite recent, some of the unforeseen consequences to be coming to life even as this paper was being written. The next section lays the foundation for these discussions by giving an overview of the purpose of the IBC and the role of financial creditors in it.

**Purpose of the IBC and the role of ‘financial creditors’**

The IBC consolidates India’s insolvency laws into one regime. The objectives of the IBC are contained in its Preamble and have been explained by the Supreme Court through its judgements. While the main objective of the IBC is to rehabilitate the debtor, the scheme of the IBC reveals that the debtor’s rehabilitation is not prioritised as a benefit in and of itself.

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11 The role of financial creditors under the IBC has not been changed by the 2018 Amendment.

12 Namely, the Presidency Towns Insolvency Act, No. 3 of 1909; Provincial Insolvency Act, No. 5 of 1920, Sick Industrial Companies (Special Provisions) Act, No. 1 of 1986, and parts of winding up and liquidation under the Companies Act, No. 18 of 2013.

Even in the Preamble, the IBC is set up as a regime to maximise the value of distressed debtors’ assets for the benefit of all their stakeholders. The provisions of the IBC make it clear that it is the wisdom of the creditors (specifically, ‘financial creditors’) which will be deferred to when deciding whether a corporate debtor should be rehabilitated.

The IBC gives the Committee of Creditors (CoC) comprising the corporate debtors’ ‘financial creditors’ a period of 180 days (which can be extended by the Adjudicating Authority by a maximum of 90 days) to approve a resolution plan; this would require a 66 per cent majority from the members of the CoC. Each financial creditor’s vote is calculated based on its share in the total debt.14 Once a resolution plan is approved by the CoC, the Adjudicating Authority under the IBC has only limited grounds based on which it can reject the plan (such as the contravention of other laws or non-payment of insolvency costs).15 If the CoC does not approve a resolution plan within the prescribed time, then the corporate debtor goes into liquidation. Evidently, financial creditors play a crucial role in the mechanism of India’s insolvency regime.

The role of ‘financial creditors’ is different from the role of ‘operational creditors’ under the IBC. Section 7 of the IBC allows a financial creditor to trigger insolvency proceedings against the corporate debtor. Operational creditors (those who have a claim against the debtor arising from the provisions of goods and services including employment or a debt in respect of the payment of dues arising under any law for the time being in force) can also trigger insolvency proceedings against the corporate debtor.16 However, a corporate debtor has more defences against an operational creditor than a financial creditor. For instance, operational creditors have to give the debtor an opportunity to pay them their dues17 and debtors can also effectively stop an operational creditor from triggering the IBC if they show that the claim of the operational creditor is disputed.18 The financial creditor, however, is neither obliged to give the debtor any opportunity to pay the due amount nor can their petition be rejected by the Adjudicating Authority because a dispute in respect of their claim exists.19 Thus, whether the creditor is owed a financial debt or an operational debt significantly alters

14 Insolvency and Bankruptcy Code, No. 31 of 2016 § 5(28).
15 Id. §§ 30-31.
16 Id. § 9.
17 Id. § 8.
18 Id. § 8(2)(a) read with §9.
the relationship between the creditor and the debtor. It also affects the extent to which the creditor has a say in the debtor’s future (through voting in the CoC). The differences between the two categories of creditors forms the crux of a lot of the analysis in this paper and will be discussed in greater detail in subsequent sections.

**Part I**

**Allottees under the Insolvency and Bankruptcy Code before the 2018 Amendment**

This section examines the treatment of allottees under the IBC as it has evolved through the decisions of the IBC’s Adjudicating Authorities and the Supreme Court. The National Company Law Tribunal (NCLT) is the designated Adjudicating Authority concerning corporate debtors under the IBC.\(^\text{20}\) Appeals from the NCLT lie with the National Company Law Appellate Tribunal (NCLAT), and appeals from the NCLAT lie with the Apex Court of the India, i.e., the Supreme Court. This section also examines how the decisions of the NCLT/NCLAT (collectively referred to as the ‘company law tribunals’) and the Supreme Court have influenced the ILC report and whether the ILC’s understanding of these decisions was correct.

**Treatment by the Supreme Court and company law tribunals**

While the 2018 Amendment deems ‘allottees’ to be financial creditors. The genesis of this concern for allottees generally, however, can largely be attributed to the treatment of a specific type of allottee – the home-buyer. Home-buyers who approached the Supreme Court and the NCLT to begin insolvency proceedings against real-estate developers all had the same grievance – developers were delaying the completion of construction despite home-buyers having paid their instalments on time. In some cases, contracts between the home-buyers and developers were such that the home-buyers would pay for their flat in advance and the developer would make monthly payments to the home-buyer until the flat’s possession was handed over (a scheme of ‘committed returns’).\(^\text{21}\) Those home-buyers who were beneficiaries of a ‘committed returns scheme’ approached the NCLT to trigger insolvency proceedings when the real estate developer did not make payments under the scheme on time.\(^\text{22}\) It was only in

\(^{20}\) Insolvency and Bankruptcy Code, No. 31 of 2016 § 5(1).


\(^{22}\) Id.
these cases that the NCLAT allowed home-buyers to trigger the insolvency process as ‘financial creditors’ under Section 7 of the IBC. The NCLT followed this precedence.

Even the Supreme Court had dealt with the question of protecting home-buyers’ interests under the IBC prior to the 2018 Amendment. In the case of Bikram Chatterji v. Union of India, real estate developers had created charges on all the land and buildings of the project in order to raise finances, leaving nothing for home-buyers in the event of a liquidation. To protect the interests of the home-buyers, the Court ordered that the flats of the home-buyers could not be sold to pay the banks/authorities, and that other projects of the group would have to be sold in order to realise these sums.

**Home-buyers as operational creditors**

In certain cases before the company law tribunals, home-buyers contended that they were operational creditors. Some of these cases had a petitioner who had obtained an order from the State Consumer Disputes Resolution Commission (SCDRC) directing the real estate developer to pay compensation for delayed construction. The petitions under Section 9 of the IBC were filed when the real estate developer did not pay the compensation as directed by the order of the SCDRC. Thus, the basis on which the petitioners were considered operational creditors was the orders of the SCDRC and not the initial amounts paid to the real estate developer. These cases were eventually settled between the parties and the petitions under Section 9 were withdrawn. In cases where the home-buyers approached the NCLT claiming that they were ‘operational creditors’ based on the advances they had made to real-estate developers, the NCLT had rejected the petitions, stating that home-buyers were not operational creditors under the IBC. The NCLT reasoned that ‘operational creditors’ were those who supplied goods or services and needed to receive payments for the same, home-buyers did not supply any good or service. The NCLT held that their grievance was related to the delayed

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26 Insolvency and Bankruptcy Code, No. 31 of 2016 § 9.
28 Id.
delivery of the possession of a property and hence they could not be considered as operational creditors under the IBC.\textsuperscript{29}

On the specific question of whether receivers of goods and services can be considered operational creditors, the NCLAT, in \textit{Overseas Infrastructure Alliance (India) Pvt. Ltd. v. Kay Bouvet Engineering Ltd}\textsuperscript{30} answered in the affirmative. The NCLAT held that receivers of goods and services who have made advance payments can be considered operational creditors. In \textit{Overseas Infrastructure}, the appellant was awarded a contract to construct a sugar plant in Sudan. The entire project was to be financed by the Government of India through a line of credit from the Indian Export-Import Bank. The appellant engaged the services of the respondent as a sub-contractor to construct the sugar plant. Accordingly, a tripartite agreement was entered into by all the parties. The appellant made an advance payment to the respondent for the construction of the plant, however, when the Export-Import Bank did not release the second tranche of payment the tripartite agreement came to an end. When the respondent refused to refund the sums advanced by the appellant, the appellant approached the NCLT to trigger insolvency proceedings against the respondent as its operational creditor.

The NCLT dismissed the application by citing the existence of a dispute (thus barring an operational creditor from triggering the IBC).\textsuperscript{31} The NCLAT found that there was no dispute regarding the operational debt. It held that the definition of ‘operational debt’ could be interpreted to cover instances where the goods/services have been provided by the debtor as well. While this situation in this case is analogous to that of home-buyers (who also pay for the service of construction), the NCLAT reached different conclusions in \textit{Nikhil Mehta} and \textit{Overseas Infrastructure}. When considering the case of home-buyers, the NCLT and NCLAT had rejected arguments which stated that home-buyers were operational creditors. In the home-buyers cases, the company law tribunals explained that operational creditors are only those who provide goods or services (such as employment) to the corporate debtor. These decisions have also held that simply because someone is not a financial creditor, they would not automatically fall under the category of operational creditors.

\textsuperscript{29} Id.
\textsuperscript{31} Insolvency and Bankruptcy Code, No. 31 of 2016 § 9.
However, the decision of the NCLAT in *Overseas Infrastructure* came after the 2018 Amendment and the NCLAT pronouncements which stated that home-buyers are not operational creditors. Significantly, there is nothing to distinguish home-buyers from the type of operational creditor described in *Overseas Infrastructure* and *Pioneer*. The key takeaway from the discussions in this section is that neither the Supreme Court nor the NCLT/NCLAT came to the conclusion that the definition of ‘financial creditor’ under the IBC extended to allottees (except in limited cases as mentioned above). While ILC bases its recommendations on the company law tribunals’ decisions relating to home-buyers, it reaches a different conclusion on the issue. The next section will examine the ILC report and its reasons for recommending that all allottees be made financial creditors under the IBC.

**The Insolvency Law Committee report**

The Insolvency Law Committee was set up by the Ministry of Corporate Affairs (Government of India) to conduct a thorough review of the IBC and help India improve its ‘World Bank Doing Business’ rank. The ILC report was cognizant of the manner in which the company law tribunals and Supreme Court had dealt with home-buyers under the insolvency regime. They saw the prevailing situation as one of confusion which required the legislature to clarify the position of home-buyers/allottees under the IBC. To this extent, the ILC recommended that the amounts raised under the real estate project from allottees be considered under entry (f) of Section 5(8) of the IBC, thus categorising them as ‘financial creditors’.

Two reasons were articulated in the ILC report for such an inclusion. The first was with respect to the legal appropriateness of including home-buyers in the definition of ‘financial creditor’ under the IBC. A financial creditor is defined as any person to whom a financial debt is due under Section 5(8) of the IBC. Section 5(8) states that a financial debt is any debt ‘along with interest, if any, which is disbursed against the consideration for the time value of money’, the sub-section then lists types of transactions which would be considered as financial debts. The ILC recommended that Section 5(8)(f) be amended to include allottees within its ambit. The ILC thought that this would be appropriate given that the definition of ‘financial debt’ is an inclusive one. Further, Section 5(8)(f) already states that forward sale or purchase agreements which have the commercial effect of a borrowing can create financial debts.

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33 Insolvency and Bankruptcy Code, No. 31 of 2016 § 5(8)(f).
Payments made by allottees often finance large parts of real estate projects. These payments are essentially tools of raising finance as the payments directly contribute to constructing the apartment.\(^{34}\) Thus, the ILC opined that allottees were analogous to financial creditors under Section 5(8)(f).

The second reason identified by the ILC for making allottees financial creditors under the IBC was a pragmatic one. The ILC was conscious of how allottees were often victims of a callous real estate sector which often delayed projects for years. Thus, there was a need to safeguard the interests of allottees and to secure and clarify their position in the event of a liquidation under Section 53 of the IBC.\(^{35}\) In 2016, two years before the 2018 Amendment/Ordinance, the IBBI amended the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations 2016 to introduce the term ‘other creditors’.\(^{36}\) Per these Regulations, allottees were neither operational nor financial creditors, consequently, they ranked below both these types of creditors in the event of a liquidation. The IBBI clarified that allottees (though the clarification specifically referred to home-buyers) were not on par with financial and operational creditors through a press note dated 18\(^{th}\) August, 2017.\(^{37}\)

The interpretation of Section 5(8) of the IBC upon which the ILC based its recommendations differs from the NCLT/NCLAT’s interpretation of the section. While the NCLAT and NCLT restricted the inclusion of home-buyers in the category of ‘financial creditor’ to those who had contracted to be a part of committed returns schemes with their real-estate developers, the ILC recommendation (and the 2018 Amendment based on these recommendations) include all home-buyers/allottees within the scope of the IBC irrespective of whether they were a part of a ‘committed returns scheme’ or not. We posit that the approach of the company law tribunals to classifying allottees as financial creditors in specific situations was deliberate and consistent with the text of the IBC. The next section examines the rationale of the NCLAT (which was later followed by the NCLT) in distinguishing between home-buyers based on the committed returns scheme.

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\(^{34}\) Report of the Insolvency Law Committee, supra note 4 at 17.

\(^{35}\) Insolvency and Bankruptcy Code, No. 31 of 2016 § 53; See, Report of the Insolvency Law Committee, supra note at 18.


‘Financial creditor’ as understood by the company law tribunals before the 2018 Amendment

To understand the definition of ‘financial creditor’ under the IBC one would have to look into the definition of ‘financial debt’. The IBC defines the former as someone to whom the latter is owed.\(^{38}\) The previous sections touched upon the definition of ‘financial debt’ under Section 5(8)(f), this section will provide a more in-depth analysis of these definitions, thus laying ground for a critical analysis of the 2018 Amendment and the Pioneer decision. The NCLAT decision in \textit{Nikhil Mehta & Sons v. AMR Infrastructures Ltd.}\(^{39}\) is significant in this regard as it was the first to allow home-buyers who were subject to defaults in the payments under committed returns schemes to trigger the IBC against the corporate debtor (real estate developer). The NCLAT reached this decision by reversing an NCLT decision which it was hearing in appeal.\(^{40}\)

The facts of \textit{Nikhil Mehta} were that a real estate developer had entered into a contract with the applicants to construct residential and commercial units for them. As a part of this contract, the applicants would pay most of the consideration in advance to AMR Infrastructures (respondent). The contract also stipulated that the respondent would pay the applicants committed returns until the possession of the apartments were handed over to them. For some time after entering into the contract, the respondent had been paying the committed returns erratically. When the payment of these committed returns (or ‘assured returns’ as it has been called in this case) stopped, the applicants filed an application under Section 7 (default in payments towards financial creditors) against the respondent.

The NCLT began its inquiry into the issue of home-buyers under the IBC from the definition of ‘financial debt’. While Section 5(8) is an inclusive sub-section, it qualifies the types of transactions which may be included within it. This qualification is categorical and not inclusive; Section 5(8) states that a financial debt means any sum of money disbursed for the ‘consideration for time value of money’.\(^{41}\) This means that notwithstanding the inclusive nature.

\(^{38}\) \textit{Insolvency and Bankruptcy Code}, No. 31 of 2016 § 7.
\(^{41}\) \textit{Nikhil Mehta} (NCLT decision).
of the definition, the IBC requires disbursements to be made against the consideration of ‘time value of money’ in order to be a financial debt.42

The NCLT decision noted that the requirement of consideration for time value for money was unique to Indian law. The UK Insolvency Act of 1986 and rules, for example, do not contain such a requirement in its definition of a debt. According to Black’s Law Dictionary (9th Edition) ‘time value’ refers to the “price associated with the length of time that an investor must wait before an investment matures or the related income is earned.”43 The rationale behind this is that money earned in the future is discounted, thus the investor/lender is being compensated for parting with money and deferring its use to some later point (when it is paid back or when it matures). This can also be understood as a compensation for the opportunity cost incurred by the investor/lender. From the analysis of the NCLT it appears that the consideration for time value of money would flow from the debtor to the creditor (in the context of the real estate sector this would mean that it would flow from the developer to the financial creditor) since ‘financial debt’ is defined as a disbursement against the consideration for the time value of money. Accordingly, the consideration can be most reasonably interpreted to flow from the person to whom the money is disbursed (debtor) to the person who is disbursing the money (financial creditor).

Given the importance of ‘consideration for time value of money’ to the definition of financial debt, the NCLT made attempts to identify such a consideration in the transaction between the home-buyers and the real estate developer. The NCLT noted that not all cases have a very clear relationship demarcating what the consideration for the money disbursed is and how it is paid. Such instances can arise under clause (f) of Section 5(8) which includes amounts raised under other transactions (such as forward sale agreements) having the effect of a commercial borrowing. This clause recognises that money can be raised using various tools including sales, and simply because a transaction is structured as an agreement of sale, it would not mean that it cannot be commercial borrowing. However, not all money raised under a forward sale agreement can be considered a ‘financial debt’ even these agreements must have some ‘consideration for the time-value of money’. Thus, the NCLT held that a simple agreement to sell something would not comprise a ‘financial debt’ even if a payment for this

42 Id. See also, Pioneer Urban Land and Infrastructure Ltd. v. Union of India (2019) Writ Petition (Civil) No. 43/2019 (Supreme Court), ¶ 40.
43 Nikhil Mehta (NCLT decision), ¶ 12.
has been made in advance. The NCLT decision in Nikhil Mehta completely ruled out the possibility of calling home-buyers/allottees who have made advances towards real-estate developers ‘financial creditors’ in the absence of a committed returns scheme.

The NCLT then considered whether the existence of a committed returns scheme would change the nature of the transaction between the allottee and real estate developer from a simple agreement to sell to one creating a financial debt. The NCLT noted that though there was money flowing from the real-estate developer (alleged corporate debtor) to the allottees (alleged financial creditor), the purpose of these committed returns was connected to the delivery of properties. There was no indication that they were calculated to serve as a consideration for the time value of money. Thus, the NCLT held that applicants were not ‘financial creditors’ capable of triggering the IBC through Section 7.

The applicants appealed against the NCLT’s decision before the NCLAT. The NCLAT agreed with the NCLT’s characterisation regarding what comprised a financial debt under Section 5(8)(f), there must be a consideration for time value of money. However, the NCLAT disagreed with the NCLT’s application of the definition of ‘financial debt’ to the present case. The NCLAT held that committed returns were a consideration for time value of money as these payments were being made until possession was handed over to the applicants. However, this line of reasoning of the NCLAT does little to clarify why committed returns could be ‘consideration for the time value of money’.

To supplement its reasoning, the NCLAT made note of various other characteristics of ‘committed returns’. The NCLAT pointed out that the applicants did not have to do anything other than make advance payments for the apartments in order to receive committed returns. This supported the argument that the payment of committed returns was consideration for the applicants’ disbursal of money as advance payments. The committed returns scheme allowed the respondent to raise finances without having to provide any collateral, thus making a case for the scheme of committed returns being a tool to raise money (which would bring it within the definition under Section 5(8)(f)).

There were two additional facts which were brought out in the appeal before the NCLAT. First, the committed returns payable to the applicants were put under the heading of ‘financial costs’ in the accounts of the respondent (the real estate developer). Second, a reference was made to a decision of the Securities and Exchange Board of India (SEBI) which
stated that in cases where real-estate developers offer committed returns, the transaction would satisfy the ingredients of a ‘collective investment scheme’. All of these factors contributed to the NCLAT holding that while the transaction between allottees and developers was one to construct and sell property, it also had aspects of a commercial borrowing because of the way in which it was designed.

To summarise, the NCLT and the NCLAT agreed that an advance payment to a real estate developer for the construction and sale of a house would not fall within the definition of ‘financial debt’. Both the NCLT and the NCLAT were looking for the ‘consideration for time value of money’ (which was missing in ordinary advance payments made by allottees) before categorising allottees as financial creditors. Even in the NCLAT decision, the existence of committed returns was crucial in determining the nature of the transaction. This aspect of the NCLAT’s decision is significant as it shows a conceptual boundary to categorising transactions as financial debts (the existence of consideration for the time value of money). In light of the company law tribunals’ analysis, neither the ILC’s report nor the 2018 Amendment seem to provide an adequate conceptual justification for expanding the definition of financial creditors to all allottees notwithstanding the existence of committed returns schemes. The next section of the paper will examine the Supreme Court decision in the Pioneer case and examine whether it was able to identify a conceptual justification for the 2018 Amendment.

The Pioneer case

As soon as the 2018 Amendment came in to force, several real estate developers challenged the constitutional validity of the amendment before the Supreme Court. The challenge was launched on a number of grounds of which two important ones being the arbitrary discrimination against real-estate developers, and the effect the 2018 Amendment had on eroding the distinction between financial and operational creditors. There were also arguments made about how allottees could blackmail real estate developers by threatening to trigger the IBC and force developers to divert funds from other projects to benefit the allottees. However, such problems are not unique to the present case and are not

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44 In the Matter of MVL Limited, Order dated 19th December, 2014 (Securities and Exchange Board of India).
45 Pioneer Urban Land and Infrastructure Ltd. v. Union of India (2019) Writ Petition (Civil) No. 43/2019 (Supreme Court), ¶ 5.
determinative of the suitability or conceptual coherence of the law with which the present discussion is concerned.

**Discrimination between real-estate developers and other operational debtors:**

In *Pioneer*, the petitioners argued that real-estate developers were closer to the class of ‘operational creditors’ under the IBC than they were to financial creditors.\(^{46}\) By treating allottees as financial creditors *vis-à-vis* real estate developers (and treating developers as financial debtors), the 2018 Amendment would violated Article 14 of the Constitution.\(^{47}\) It was argued that real estate developer were operational debtors and that the amendment treated real estate developers differently from other members of its class. The real estate developers urged that the classification of real estate developers as operational debtors was under-inclusive as it excluded other similarly placed operational debtors.

The Supreme Court responded to this argument by referring to the latitude which is normally allowed to the legislature when deciding the constitutional validity of economic legislations. In doing so, it referred to previous Supreme Court judgements which held that an economic legislation cannot be in violation of Article 14 only because it does not contain or make a perfect classification while giving effect to a policy.\(^{48}\) Given that economic problems can be complex and require equally complex solutions, the legislature must be allowed to solve these problems through economic experimentation.\(^{49}\) Economic legislation might affect only one person or a specific class of persons, there may also be situations in which economic legislations affect some members of a class more harshly than others.\(^{50}\) However, if a classification is made to promote a general public interest and the legislature can cite special circumstances which set some members of a class apart from others, then a legislation cannot be struck down as unconstitutional simply because it suffers from under-inclusion.\(^{51}\) In the case of real estate developers, the special circumstances were the delays and mismanagement with which the real estate sector was plagued, this led to the frustration of large investments made by allottees.\(^{52}\) In addition to citing the latitude normally given to economic legislation to show

\(^{46}\) Id. ¶¶ 5, 11.
\(^{47}\) Id. ¶ 32.
\(^{48}\) Id. ¶¶ 35-40.
\(^{49}\) Id. ¶ 35.
\(^{50}\) Id. ¶ 38.
\(^{51}\) Id. ¶ 35.
\(^{52}\) Id. ¶ 38-39.
the constitutionality of the 2018 Amendment, the Supreme Court also distinguished real estate developers from other operational debtors in order to mitigate the petitioner’s contention that the 2018 Amendment led to the creation of a class which was under-inclusive.

In the context of real-estate developers the Court identified three distinguishing characteristics which set them apart from other operational debtors. Firstly, home-buyers finance the real-estate developer and there is no consideration from the latter to the former as would normally be seen in the case of operational creditors.53 Secondly, (the Supreme Court found) that there exists a consideration for the time value of money in the transaction,54 and thirdly, that home-buyers are capable of participating in CoC meetings as they (like of other financial creditors) have a long-term interest in the corporate debtor.55 Interestingly, by examining the difference between real estate developers and other operational debtors, the Court has implicitly stated that they fall within the class of operational debtors but deserve differential treatment because of how they differ from other members of that class.

The first distinguishing characteristic identified by the Court related to the nature of transaction between real-estate developers and home-buyers. In most cases, consideration for goods and services flows (or ought to flow) from an operational debtor to an operational creditor.56 Thus, if an entity supplies goods or services to company, it becomes the operational creditor of that company. The relationship is reversed in the case of allottees and real estate developers, allottees are the ones who pay for the service (construction of an apartment) which is rendered by the real estate developer.57

Such a line of reasoning seems unpersuasive because it ignores other instances wherein the supplier of goods and services may be considered a corporate debtor.58 The Supreme Court stated that other projects for which advance payments were made such as ‘turnkey projects’ and ‘capital goods’ would not be analogous to real estate projects because the advance payments were made for the purpose of specific customisation required by the buyer.59 While this might to true, it would be hard to defend that there are no projects which are financed partly

53 Id. ¶ 40.
54 Id.
55 Id. ¶ 41.
56 Id. ¶ 40.
57 Id.
59 Pioneer, ¶ 40.
or entirely by the buyers (as noted by the Court, home-buyers finance between 50 per cent – 100 percent of the real estate projects). The transaction in the case of *Overseas Infrastructure* shows that there are other transactions which are analogous to those between real-estate developers and allottees. The Court also stated that such ‘turnkey’ projects lacked the essential ingredient of ‘consideration for time value of money’ which was required in a financial debt. The consideration for time value of money was the second distinguishing characteristic identified by the Court.61

The respondents argued that ‘time value of money’ was present in the transaction between real estate developer and the allottees.62 It was present for the allottees because they gained the benefit of acquiring an apartment at a cheaper price than they would have had to pay once it was already constructed.63 Thus, the respondents argued that the allottees gained the ‘time value of money’ by saving money because of their early investment in the apartment. Time value of money was also present for the real estate developers as they received money for the construction of the apartment with every investment that was paid.64 The Court agreed with this reasoning and reiterated the respondent’s arguments to conclude that a consideration for the time value of money’ in the transaction between allottees and real estate developers.65 A charitable reading of this part of the Court’s judgement would suggest that the allottees gain the difference between the price they would have had to pay for an already constructed apartment and the total price paid through instalments to construct the apartment.66 This difference, was the time value of money gained by the allottees.

Such a construction of ‘consideration for time value of money’ does not sit well with how it has been defined by various authorities, including the ones cited by the Supreme Court in its decision.67 As explained above, time value for money refers to the price associated with having to defer the spending of that money to a later time. Examples of this include waiting for an investment to mature or for a loan to be paid back. However, in the case of real estate developers, the use of the money itself is to purchase the apartment. Thus, there is no deferment

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60 *Id.* ¶ 54.
61 *Id.* ¶ 40.
62 *Id.* ¶ 12.
63 *Id.*
64 *Id.*
65 *Id.* ¶ 40.
66 *Id.*
67 *Id.* ¶ 61.
of enjoyment of that money, or to being able to use it. No opportunity cost is incurred by the allottee as they are not waiting for it to be returned or its monetary equivalent (in the form of an apartment) to be returned. Time value of money cannot be characterised as the ability to save money on an investment or transaction. By this logic, a company which pays to have its tools/machinery manufactured rather than buy them once they are put up for sale would also be gaining the time value of money. Even the NCLAT decision in *Nikhil Mehta* differentiated forward sale agreements, and other advance payments from transactions which created a financial debt. They required an additional element which made the sale a mere tool to raise finance, and identified the ‘committed returns’ as this requirement. However, the *Pioneer* case and the 2018 Amendment deem all allottees as financial creditors irrespective of the existence of ‘committed returns’. Thus, the analysis of the NCLT and NCLAT on the existence of ‘consideration for time value of money’ appears to be more persuasive simply because its identification of such consideration is closer to the definition of what comprises ‘time value of money’.

The third distinguishing factor identified by the Supreme Court is that unlike most operational creditors, allottees are vitally concerned with the financial health of the real-estate developer given that the completion of the project will be jeopardised if they are not financially viable. This was explained as the reason for why allottees would vote in the CoC keeping in mind the same interests as other financial creditors. While it is true that allottees are interested in ensuring that the real estate developers complete their projects, this does not address the concern raised by the petitioners regarding the position from which allottees participate in CoC meetings. While allottees may have an interest in the long-term viability of a real estate developer, this concern only exists to the extent that the allottees are able to secure their one-time investment.\(^68\) This is different from other financial creditors such as banks, debenture holders etc. which are interested in the long term sustainability of the developer notwithstanding whether some projects are delayed/terminated.\(^69\) Thus, in a situation where the financial viability of a developer is at odds with their ability to complete all projects, it is unlikely that allottees would acquiesce to suspending a project of the developer in which they have an interest (even if it means that their investments will be refunded).\(^70\) This is because the

\(^{68}\) Id. ¶ 44.
\(^{69}\) Id.
\(^{70}\) Id.
interest of allottees is not purely financial, for instance, only 8 per cent of the allottees in *Chitra Sharma v. Union of India*\(^{71}\) wanted refunds and the rest wanted possession of their flats.\(^{72}\) Further, as noted by the Supreme Court, allottees have often invested large sums of their hard-earned money; in such cases it would be all the more difficult for them to restructure their investment or condone delays in the interest of keeping the developer a going concern.

**Blurring the distinction between operational and financial creditors: ‘Pioneer’ in light of ‘Swiss Ribbons’**

The case of *Swiss Ribbons v. Union of India*\(^{73}\) (which was decided shortly before the Pioneer case but after the 2018 Amendment) cannot be ignored while debating the characteristics of a financial creditor. In *Swiss Ribbons*, the differential treatment accorded to financial and operational creditors under the IBC was challenged on the grounds of arbitrariness (thus violating Article 14 of the Constitution). Upholding the constitutional validity of this differentiation under the IBC, the Supreme Court used the case as an opportunity to articulate the differences between the two categories of creditors. Though the judgement largely dealt with the characteristics of financial creditors who were not individuals (such as banks) it did not excuse individual lenders from meeting the criteria the IBC sets out for being a called a financial creditor. The only manner in which individual financial creditors were different from other financial creditors was that they would be represented by an insolvency professional because they tended to be numerous.\(^{74}\)

It is significant to note that while referring to individual financial creditors, the Court referred to individuals such as debenture holders and deposit holders. At one instance, the Court also referred to persons with home loans. The however, the Court never referred to all home-buyers/allottees in its judgement (except when directly quoting Section 5(8)(f)). Even when quoting parts of the ILC report that spoke about individual financial creditors which included home-buyers, the Court emphasised deposit holders and debenture holders and did not refer to home-buyers.\(^{75}\) It is unclear why the Court chose to emphasise home-buyers with home loans over other home-buyers. The Court may have refrained from delving into the issue of including

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\(^{71}\) *Chitra Sharma v. Union of India* (2018) Writ Petition (C) 744/2017 (Supreme Court).

\(^{72}\) *Id*. [40].

\(^{73}\) *Swiss Ribbons v. Union of India* (2019) Writ Petition (C) 99/2018 (Supreme Court).

\(^{74}\) Insolvency and Bankruptcy Board of India (Insolvency Resolution for Corporate Persons) Regulations, 2016 IIBBI/2016-17/GN/REG004, Regulation 16A read with Regulation 12.

\(^{75}\) *Swiss Ribbons*, ¶ 25.
all home-buyers/allottees in the definition of ‘financial creditor’ because it was not being contested in *Swiss Ribbons*. The issue before the Court in *Swiss Ribbons* was in relation to the general characteristics of financial and operational creditors to which it spoke in unequivocal terms which have been explained below.

*Swiss Ribbons* identified characteristics of financial creditors which help maintain the distinction between them and operational creditors. Financial creditors tend to have fixed repayment schedules making it easier to ascertain a default (which is a ground for triggering the insolvency resolution process under Section 7). Operational creditors’ claims are more likely to be disputed and require adjudication before it can be ascertained if a default has occurred.\(^{76}\) For instance, the goods supplied by the operational creditor may be of substandard quality, in which case reduced payment would not necessarily amount to a default.\(^ {77}\) Financial creditors normally lend money on a term loan or for working capital which enables a company to set up and operate a business. Operational creditors normally only participate in the operation of a business and not its set up. Another important characteristic of a financial creditor is that they are involved in assessing the long-term viability of a corporate debtor. Thus, they will be able to restructure their loans and enable the corporate debtor to remain a going concern.\(^ {78}\) For all these reasons, the Supreme Court in *Swiss Ribbons* held that there exists a difference (‘*intelligible differentia*’) between financial and operational creditors, making the different treatment accorded to both classes constitutional under Article 14.

The judgement in *Pioneer* drove around the characteristics mentioned in *Swiss Ribbons* by differentiating between other operational creditors and real estate developers (as discussed above) and emphasising the interest of the allottees in the long-term viability of the real-estate developer. However, the nature of long-term interests that financial creditors normally have is different from those of allottees. As already mentioned, allottees are more likely to prioritise the completion of those projects of the corporate debtor of which they are a part. They tend to be interested in the viability of the real estate developer only to the extent that it allows for the construction of their apartments. The inappropriateness of categorising allottees as financial creditors becomes stark when reading the *Swiss Ribbons* judgement. While the judgement acknowledges the existence of financial creditors who are individuals, the term is still restricted

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\(^{76}\) *Id.*, ¶ 27.

\(^{77}\) Sale of Goods Act, No. 3 of 1930 § 59.

\(^{78}\) *Swiss Ribbons*, ¶ 28.
to persons who have made and investment/loaned money to the debtor with the expectation of getting money in return (deposit holders/debenture holders/banks). The next part of the paper examines the unintended consequences of categorising allottees as financial creditors, some of these are independent of the conceptual correctness of such a classification.

**Part II**

**Implications and unintended consequences of the 2018 Amendment and Pioneer judgement**

The 2018 Amendment gives allottees the rights to trigger the IBC as ‘financial creditors’ and participate in CoC meetings, both of which would affect the real estate developer and their other creditors during the insolvency resolution process. However, the 2018 Amendment does not significantly alter the position of allottees in case of a liquidation. In the Pioneer judgement, the Court stated that allottees were unsecured creditors.\(^79\) Section 53 of IBC gives first priority to claims relating to the costs of the insolvency proceedings and liquidation proceedings; second priority is given to workers’ dues and debts owed secured creditors (ranked equally); the third priority is given to employees’ dues; the fourth to debts of financial unsecured creditors, government dues (such as taxes, money owed to the Consolidated Fund of India etc.) and any remaining amount owed to secured creditors (ranked equally); other dues and claims (such as those of ‘other creditors’) are paid to fifth, and the sixth and seventh to be paid are the preference and equity shareholders respectively. Thus, the liquidation waterfall does not differentiate between financial and operational creditors, it is only concerned with whether a creditor is secured or unsecured. The 2018 Amendment effectively moves an allottee from being the sixth priority to being the fourth priority in the liquidation waterfall; it puts them in the same position as unsecured operational creditors (for the purpose of distributing assets during liquidation). The rest of this section will discuss some effects of the 2018 Amendment which Parliament may not have foreseen or intended.

**Allottes’ position in insolvency resolution plans**

As far as the insolvency resolution plan is concerned, after the 2018 Amendment, allottees can use their votes in the CoC to keep the real-estate developer a going concern. However, it is

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\(^{79}\) Pioneer Urban Land and Infrastructure Ltd. v. Union of India (2019) Writ Petition (Civil) No. 43/2019 (Supreme Court), ¶ 54.
unclear why the other financial creditors would be ill-equipped to make this decision when necessary and viable. An allottee’s right to refund may have been protected before the 2018 Amendment even if they were operational creditors. Resolution plans are required to prioritise payments to operational creditors over payments to financial creditors (including payments to allottees).\textsuperscript{80} This means that operational creditors will receive at least as much as they would have in case of a liquidation in any resolution plan. In \textit{Swiss Ribbons}, it was noted that out of the 80 cases which had been resolved since the IBC came into force, operational creditors have not only been paid before financial creditors in resolution plans but also recovered slightly more than the financial creditors.\textsuperscript{81} While predicting the type of impact allottees would have on CoC meetings is outside the scope of this paper, it would be reasonable to say that most allottees (especially home-buyers) will be dependent on other financial creditors to adjust their loans or commit extra funds to keep a real estate developer alive as a going concern. This is because allottees are less likely to have access to more funds (unlike banks). And unlike other financial creditors, allottees may not prefer to be monetarily compensated at some later time through debt restructuring as their primary interest is to possess a completed apartment.

\textbf{Use of the IBC instead of alternative remedies}

In the \textit{Pioneer} judgement the Supreme Court had maintained that RERA and the Consumer Protection Act 1986 (now replaced by the Consumer Protection Act, 2019) would continue to exist as remedies for the allottees. The Court also held that the RERA was the appropriate forum to approach in case construction was delayed or in case allottees wanted compensation.\textsuperscript{82} The IBC, according to the Supreme Court, would be triggered by allottees only when they wanted a change in management. While this is the only reasonable (and ideal) situation under which allottees should trigger the IBC, there is nothing in the IBC nor the \textit{Pioneer} decision which ensures such a prudent use of the insolvency process by allottees. For instance, in \textit{Chitra Sharma} and many of the cases brought before the company law tribunals prior to the 2018 Amendment, allottees (mainly home buyers) either wanted to expedite construction or they wanted a refund of their payments. The IBC has a more coercive effect on the real estate developer than RERA and the Consumer Protection Act. This is because real estate developers are affected by RERA and the Consumer Protection Act only the court’s adjudication of the

\textsuperscript{80} Insolvency and Bankruptcy Code, No. 31 of 2016 § 30(2)(b).
\textsuperscript{81} Swiss Ribbons, ¶ 4.
\textsuperscript{82} Pioneer, ¶ 29.
claims before it. The IBC subjects real estate developers to the insolvency process from the very beginning (once a default is shown); this is something which real estate developers wish to avoid. Thus, allottees may choose to trigger the IBC for grievances that can be addressed by other laws and past experiences (*Chitra Sharma, Nikhil Mehta* etc.) are evidence of this tendency.

Recent developments have shown that the government has already started grappling with this particular consequence of the 2018 Amendment. In Mumbai, India’s financial capital, half the cases brought before the NCLT (by allottees, specifically home-buyers) are against real estate developers. These cases could disrupt the functioning of otherwise properly-operating companies. The Government of India is now considering the imposition of a threshold requiring at least 5 per cent of the allottees to approach the NCLT before the insolvency process can be triggered against a real estate developer. However, even if such a threshold is imposed, the interests of allottees as examined in this paper which make them ill-placed to trigger the IBC would continue to skew the purpose of the insolvency resolution process.

**Determination of defaults**

Section 7 of the IBC allows financial creditors to trigger it in case of a ‘default’. In case of financial creditors, it is easy to determine what amounts to a default. Defaults refer to instances of not repaying a debt in a timely fashion and information regarding defaults can be found with information utilities. Section 214 of the IBC states that the core function of an information utility is to maintain a data base of financial information in an accessible format. Financial information refers to records of the debts, liabilities, assets (with or without charges on them), and balance sheet and cash flow information of a person. For allottees who are a part of committed returns schemes, a default can be said to occur when the committed returns are not paid or when a cheque issued to pay them has been dishonoured. However, the determination of the occurrence of a default becomes tricky when considering the interests of allottees who are not a part of a committed returns scheme. Seeing as many allottees are aggrieved by delayed...

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84 *Id.*
86 Insolvency and Bankruptcy Code, No. 31 of 2016 § 3(13).
construction, a relevant question would be whether such delay would amount to a default. Given that the decision in *Pioneer* interpreted receiving possession of a constructed house as ‘consideration for the time value of money’ it would seem fair to consider a delay in such delivery of possession as a default.

The issue of determining defaults becomes even more important when considering the fact that the NCLT must only be satisfied that a default exists with respect to financial creditors and cannot go into the merits of the case even if the default is disputed. Construction contracts often excuse delays due to circumstances which the real-estate developer could not control. It would seem unfair to begin insolvency proceedings against real estate-developers in such a case but the NCLT’s hands would be tied if delays are considered defaults.

The NCLT would normally ascertain the default of a financial debtor based on the information provided by information utilities. It is unclear how these information utilities will provide information on whether a delay has occurred to cause a default; this will be difficult given that some states are yet to have fully functioning authorities under RERA (which have information relating to real-estate projects). One might say that the 2018 Amendment may be read down to only apply to allottees who are a part of committed returns schemes (thus allowing the NCLT to determine default by checking if the real estate developer has not been paying the committed returns). However, the Court in *Pioneer* unequivocally stated that the 2018 Amendment must not be read down. It would also seem puzzling if the courts and tribunals (through interpretation) restricted the 2018 Amendment to allottees who are a part of a committed returns scheme. The Supreme Court and the ILC report both stressed on the hardships faced by allottees on account of delays in construction notwithstanding membership to a committed returns scheme. In *Pawan Dubey v. J.B.K. Developers* the NCLT refused to consider a ‘delay’ as a default and stated that allottees could only seek relief as financial creditors if there was a failure in the timely payment of committed returns by the developer.

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87 Innovative Industries, ¶ 84.
88 Insolvency and Bankruptcy Code, No. 31 of 2016 § 7(4).
89 Pioneer Urban Land and Infrastructure Ltd. v. Union of India (2019) Writ Petition (Civil) No. 43/2019 (Supreme Court), ¶ 87.
90 Pawan Dubey v. J.B.K. Developers (2018) SCC Online NCLT 794. The tribunal distinguished the facts of this case from those of *Nikhil Mehta* by stating that there was not default in repayments in a committed returns scheme. The tribunal in *Pawan Dubey* held that a delay in construction in and of itself would not be a ground for allottees to trigger the IBC under Section 7.
91 Id. ¶ 29.
Though allottees have been bought within the ambit of the IBC, the definition of default remains unchanged and the *Pioneer* case does not provide any guidance in this regard. Accordingly, *Pawan Dubey* may still apply to allottees effectively denying them the right to trigger the IBC in case of a delay (despite the 2018 Amendment).

Allottees can not only trigger the IBC for defaults in payments due to them but also defaults in payments due to other financial creditors.\(^{92}\) This would mean that in case there has been a default on a loan provided by a bank and the bank is willing to restructure the loan without triggering the IBC, the allottee could still trigger the IBC. The ability trigger the IBC so easily is dangerous as it could jeopardise the otherwise smooth functioning of a company. For instance, when the IBC was triggered against one of the petitioners in *Pioneer* by the buyers of 14 out of 19,062 units sold by the real estate developer, the Infrastructure Finance Development Company (and Indian finance company) prematurely invoked a letter of credit to recover the entire amount (one billion rupees) due to them from the real estate developer. Granted that there may be divergences of interests between other financial creditors as well, however, it may be argued that their bottom line is the same because all of them have a purely monetary interest in the corporate debtor. They are thus in a better position than allottees to decide when (and whether) to trigger the IBC.

*Nature of precedent set*

As already discussed in the Introduction, deeming fictions can be used to include the impossible with the meaning of a word or phrase, or they can simply be used to clarify an interpretation of a provision by making express what is already implied. Supreme Court in *Pioneer* put a lot of effort into explaining why the ‘deeming fiction’ used by the 2018 Amendment to make allottees financial creditors was only clarificatory in nature. This meant that the text of the existing Section 5(8)(f) already subsumed allottees and the 2018 Amendment only made express what was already implied. However, a perusal of the wording of the Section and the manner in which it has been interpreted by the company law tribunals does not support the Supreme Court’s conclusion regarding the nature of the deeming fiction.

Cases where the company law tribunals discussed Section 5(8)(f) have already been analysed. In none of these decisions did the company law tribunals conclude that Section

\(^{92}\) Insolvency and Bankruptcy Code, No. 31 of 2016 ¶ 7(1).
5(8)(f) would include all allottees, rather they reached the opposite conclusion and held that only some allottees (those who were a part of committed returns schemes) would fall within the definition. Further, the IBBI amendment to its Regulations in August 2017 and the press note that followed showed that the IBBI believed that home-buyers were neither operational creditors nor financial creditors, which is why they were put under the category of ‘other creditors’.

The ability for a legislature to use a deeming fiction to amend a legislation cannot be questioned. As noted by the Supreme Court in Pioneer the text of the legislation binds only the courts and not the legislature, this means that the legislature has more freedom when amending the legislation than the court does while interpreting it. However, we argue that the legislature’s use of a deeming fiction to amend the IBC has undesirable implications even though it is not illegal. The 2018 Amendment has blurred the distinction between financial and operational creditors. Even if the Supreme Court’s distinction (in Pioneer) between real estate developers and ‘other’ operational debtors is considered to be persuasive, it is very fact-specific (the nature of contracts between real-estate developer and allottees). There is no guidance given to investors and entrepreneurs on what would warrant classifying other ‘operational debtors’ as ‘financial debtors’. While attempting to distinguish between real estate developers and other operational debtors in Pioneer, the Supreme Court lost the opportunity to set out criteria wherein operational debtors may generally be classified as financial debtors.

**Blurring the line between financial and operational creditors**

The distinction between financial creditors and operational creditors is unique to India\(^\text{93}\) and has been discussed in previous sections. The retention of this distinction between the two types of creditors (and debtors) is something that Parliament and the courts must tend to seriously. There are no standards which the business community can fall back on to ascertain where they stand; they are wholly reliant on the signalling of the legislature and judiciary for this. It is thus vital that the legislature refrains from using deeming fictions as it did in the 2018 Amendment as it eats away at the objectives of separating financial and operational creditors (and consequently financial and operational debtors).

\(^{93}\) Swiss Ribbons v. Union of India (2019) Writ Petition (C) 99/2018 (Supreme Court), ¶ 25.
In *Swiss Ribbons*, the Solicitor General of India articulated reasons for the legislative policy enshrined in the IBC. These reasons being the maintenance of predictability and certainty, protection of the interests of the corporate debtor, ensuring that liquidation is the last resort. The 2018 Amendment militates against the first two policy objectives of the Code. The amendment makes the debtor vulnerable to a larger number of insolvency proceedings being initiated against it, more importantly, it reduces the predictability with which different businesses can assess their positions *vis-à-vis* the insolvency regime. As already mentioned, the ‘unique’ relationship between allottees and real estate developers, where the debtor supplies the goods/services is actually quite common. This might arise in cases where any entity commissions the services of another to build or provide something and partly finances the same. The insurance sector is another example where this relationship may exist, policy holders often invest large sums of money over their lifetimes to secure themselves against hazards such as fires, accidents, etc. They too contribute to the pool which helps finance pay-outs made to them. Based on the *Pioneer* judgement, one could even make a case for policy holders to be considered as ‘financial creditors’.

The real estate sector has come to a point where allottees are increasingly becoming victims of mismanagement, this is beyond dispute. The number and duration of delays is alarming and something which requires urgent action. Further, it cannot be ignored that allottees are affected by insolvency proceedings against the real-estate developer. However, the solution to these issues should not have been sought through the IBC. The mandate of the IBC has already been discussed and it is clear. It is meant for the maximisation of the value of the debtors’ assets so as to allow creditors to decide whether to keep it as a going concern or liquidate it. In either scenario, the IBC serves the greater economic goal of ensuring that credit is efficiently allocated within the economy. The use of insolvency law as a tool to fix problems which plague a sector is inappropriate, especially when there are other alternatives which may have been pursued to protect the interest of allottees.

**Alternative methods for protecting allottees under the IBC**

Ideally, Parliament should protect consumer pre-payments in general when the entity to which such pre-payments were made is subject to insolvency proceedings. While a minimum amount which must have been paid by the consumer may be set in order for this protection to take effect, consumer pre-payments should be protected when a resolution plan is drafted and when
the debtor goes into liquidation. One way of doing this is through the creation of a trust. Recommendations for protecting consumer prepayments were made in the UK’s Law Commission Report on Consumer Prepayments (ULC report).\(^{94}\) The report noted that consumers suffer losses when companies enter the insolvency process. These losses range from simple gift vouchers to investments in home improvements to the purchase of new homes. The ULC report also recommended that consumers whose claims meet certain criteria may be given priority in payments from the bankrupt’s estate.\(^{95}\)

Assets held in trusts or for any third party are left out of the liquidation estate under the IBC.\(^{96}\) In Bikram Chatterji the Supreme Court ordered the buildings and lands allotted to home-buyers to be left out of the insolvency estate, thus preventing creditors from using these assets to recover their debts. Another means of protecting consumer pre-payments is to give them a place in the hierarchy of payments during liquidation and prioritise their payments along with those of operational creditors (as was also recommended by the ULC report). In the context of the real estate sector, such measures will be easy to enforce given that RERA already requires 70 per cent of the allottees’ payments to be put into an escrow account.\(^{97}\)

The benefit of such alternatives is that they take a more consistent and systemic approach to the problem. The insolvency regime cannot be expected to solve the problems (though persistent) of specific sectors. However, it can prioritise the interests of stakeholders based on how society perceives them and how equipped they are to bear the costs of insolvency (as is already done in the case of employees’ dues payable by the corporate debtor).\(^{98}\) Measures taken to protect consumers generally (including allottees) would have been less disruptive to the insolvency regime in India and would not have required the linguistic and legal feat involved in classifying home-buyers/allottees as financial creditors.

**Conclusion**

The IBC’s provisions and Preamble show that its main purpose is to maximise the value of the debtor’s assets for all stakeholders and improve credit markets and the ease of doing business

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\(^{94}\) Law Commission, *Consumer Prepayments on Retailer Insolvency*, 2016 Cm. 368, at 115-117 (UK)

\(^{95}\) *Id.* ¶¶ 8.92, 8.106 - 8.109.

\(^{96}\) *Insolvency and Bankruptcy Code*, No. 31 of 2016 § 36

\(^{97}\) *Real Estate (Regulation and Development) Act*, No. 16 of 2016 § 4.

in India. There is little room for equity within the scheme of the IBC, this is demonstrated by the clearly circumscribed role of the NCLT. While the NCLT plays an important role in the insolvency resolution process, its powers and role have been clearly delineated. The NCLT can reject the resolution plan of the CoC on limited grounds and must approve the same if it meets all the required criteria under the IBC. All of these characteristics of the IBC give it a proceduralist leaning, its main purpose is to bring together creditors so that they can decide the future of the financially distressed corporation.

However, an insolvency regime cannot be divorced from the realities which surround it. The IBC is cognizant of the socio-economic circumstances which surround it and it has taken steps to address them. For instance, in the liquidation waterfall, the IBC prioritises employees’ and workers’ dues. This is a reflection not just of a societal reality (the vulnerability of workers and employees) but also of a societal prioritisation. While the IBC is capable of accommodating societal concerns and urgencies, it should not do so in an unfettered manner. The example of the treatment of employees and workers shows that to give a class of persons a priority in payments, they need not be given other rights (such as those flowing from being a financial creditor).

One might ask whether home-buyers/allottees would have been included in the insolvency regime if the real-estate sector was not in its current deplorable state. Given the extent to which the flaws in the real estate sector have been cited by those who have suggested, enacted and upheld the 2018 Amendment, the answer to this question would most reasonably be in the negative. In addition to setting a dangerous precedent, the 2018 Amendment strikes at the conceptual consistency of the IBC and moves it away from its otherwise proceduralist approach. One of the biggest strengths of the IBC is the certainty with which financial creditors can trigger it and use it as an opportunity to change the management of their corporate debtor and reorganise its debt. The expediency and efficiency of such a process may tempt Parliament to use it as a tool to remedy other issues or sectors. However, Parliament must be cautious to not misallocate the efficiency of its insolvency regime as this may risk compromising it all together.

99 Insolvency and Bankruptcy Code, No. 31 of 2016 §§ 30-31.