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Clash of IBC and RERA Laws – IBC Wins!

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The recent judgment of Honourable Supreme Court in Pioneer Urban Land & Infrastructure Limited & Others v Union of India[1] apart from holding the constitutional validity of the amendment made to Insolvency & Bankruptcy Code, 2016 (IBC/Code) vide Insolvency & Bankruptcy Code Amendment Ordinance, 2018 (Amendment Ordinance) has held that the provisions of RERA laws should give way to the provisions of Code, when both of them clash. This article is an attempt to understand the fear of developers, the standpoint of allottees and the final verdict of the Court to the extent of the caption of the article.

The Supreme Court is faced with large number of writ petitions challenging the constitutional amendments made to IBC, wherein the 'allottee[2]' of 'real estate project[3]' is included in the definition of 'financial creditor', the allottee is being allowed to be represented in Committee of Creditors (CoC) via authorised representatives and rights and duties of authorised representatives have been challenged.

Prior to the Amendment Ordinance, the National Company Law Appellate Tribunal (NCLAT) in the matter of Nikhil Mehta and Sons (HUF) v AMR Infrastructure Limited has held that amounts raised by developers under the assured return schemes had the 'commercial effect of borrowing' and accordingly can be called as 'financial creditor' to trigger the corporate insolvency resolution process (CIRP) under IBC. Further, the Supreme Court in the matter of Chitra Sharma & Others[4] has allowed the appointment of a representative of home buyers to participate in the meetings of Committee of Creditors to protect the interest of home buyers pertaining to CIRP of Jaypee Infratech Limited which was triggered by IDBI Bank. Similarly in the matter of CIRP of Amrapali Group, the Supreme Court has passed an order[5] allowing the representative of home buyers to participate in CoC meetings to protect the interest of such home buyers.

Basis the above judgments passed by Supreme Court, the Insolvency Law Committee stated to make amendments to IBC to clarify, as a matter of law, allottees of real estate project as financial creditors. Accordingly, taking the proposal of such law committee into consideration, the Government has made amendments to IBC vide Amendment Ordinance to include the allottee in the definition of financial creditor. As stated earlier, the said amendments were in challenge qua the writ petitions filed.

Petitioner's Reasoning – Developers Standpoint:

The main reasons for which the amendments are being challenged are summarised hereunder:

- The amendment to include the 'allottee' in the ambit of 'financial creditor' would act against the objects of the Code, which is to maximise the value of assets so that the shareholders of a corporate debtor do not suffer from bad/poor management.

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[1] 2019 (8) TMI 532- Supreme Court
[2] The expression has the same meaning as laid down in 2(d) of Real Estate (Regulation & Development) Act, 16
[3] The expression has the same meaning as laid down in 2(zn) of Real Estate (Regulation & Development) Act, 16
[4] 2018 (8) TMI 661 - Supreme Court
[5] Bikram Chatterji & Others v Union of India - 2019 (7) TMI 1233 - Supreme Court

- The amendment looks at only 'bad eggs' and entities which have completed building projects in time and are compliance can be jeopardised by allottees by filing Section 7 petitions to blackmail the developers into making payments which would divert funds which are otherwise to be used for the project.

- A perfectly good management which has number of projects in hand can be removed at instance of one allottee and either replaced in which case the huge funds infused by developer would be at naught or worse still lead to commercial death, if CIRP does not result in any success. In other words, the amendment gives such a power to the allottee to make a perfectly solvent company turn into an insolvent company which is not in the best interests of anyone including allottees.

- The amendments were notwithstanding to the fact that there was a separate legislation namely, the Real Estate (Regulation & Development) Act, 2016 (RERA) which deals in detail with real estate sector and provides for adjudication between the allottees and promoters, with large number of safeguards for the allottees.

- A reading of the decision of Supreme Court in the matter of Swiss Ribbons[6] would reveal that not a single characteristic mentioned for 'financial creditor' would not apply to the allottee and accordingly the amendment requires to be set aside.

- The home buyers would not fall within the category of 'financial creditor' or 'operational creditor' and should therefore be subsumed only with RERA, which is a complete code dealing with real estate industry. RERA being a special act as opposed to the Code, which is general act and ought, therefore RERA has to prevail.

Respondent's Defence – Union of India's Standpoint:

- IBC is not a recovery mechanism. When a home buyer approaches National Company Law Tribunal (NCLT) and his petition being admitted, he does not get his money back in the near foreseeable future and has to stand in line and await either the vagaries of a resolution plan which gives him certain percentage of money and/or completes the project for him. In the event of winding up, the home buyer has to stand in line and receive whatever is available. As opposed to this, the home buyer approaches RERA in which, upon showing breach on part of real estate developer, they would claim whatever has been paid in full together with interest thereon. This being the case, it is wholly incorrect to paint a picture that the allottee would make the solvent developer as insolvent at an earliest opportunity because of the amendment.

Respondent's Defence – Allottees Standpoint:

- Number of counsels appearing for individual allottees argued that the RERA and consumer fora are not meaningful remedies for allottees at all. They have stated that these beneficial amendments if struck down, they would be back in the same position as they were before enactment of other measures, which have not really worked to afford them a relief.

The Decision of Supreme Court:

[6] (2019) 4 SCC 17

The Supreme Court after setting out Para 120 of Swiss Ribbons (supra) stated that the legislative judgment in economic choices must be given a certain degree of deference by Courts and the amendments made to IBC has to be read in the said context and proceeded to lay down the reasons for the current amendments as pointed by Insolvency Law Committee, which found that the delay in delivery or possession by developers has become a common phenomenon, and the amounts raised from home buyers contributes significantly to the financing of construction of such flats.

That being the case, it was important therefore to clarify that home buyers are treated as financial creditors and have their rightful place in CoC, when it comes to making important decisions as to the future of company, which is the execution of real estate project in which the buyers are ultimately housed.

IBC v RERA:

The Supreme Court after referring to the various provisions of RERA laws has stated that Section 88 of RERA it was stated that the provisions of RERA were in addition to and not in derogation of the provisions of any other law for time being in force and as per Section 89, RERA is to have effect notwithstanding anything inconsistent contained in any other law for the time being in force.

Then, referring to Section 238 of Code, which states that the provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law, the Court stated there is no provision similar to Section 88 of RERA in the code, which is meant to be a complete and exhaustive statement of the law insofar as its subject matter is concerned.

The Court further held that the non-obstante clause of RERA came into force from 1st May 16, as opposed to non-obstante clause of code which has come into force from 1st December 16. Further, the amendment with which Petitioners are concerned came effective from 6th June 18. **Under these circumstances, the Court stated that it is little difficult to accede the arguments advanced by Petitioners, that RERA is a special enactment which deals with real estate projects and must, therefore be given precedence over the code, which is a general enactment dealing with insolvency generally.**

The Court further held that the fact that RERA is in addition to and not in derogation of the provisions of the any other law, also makes it clear that the remedies under RERA to allottees were intended to be additional and not exclusive remedies.

The Court also stated that when dealing with two acts which have non-obstante clause, the later act should be given way to the earlier act, for the reason, that it is presumed that the Parliament is aware of the former act when making the later act and it is such wisdom, the later act has to be given precedence. Also, presence of Section 88 in RERA which states that remedies available under RERA are in addition to and not in derogation of other acts would also make it clear, that code would prevail over RERA.

Accordingly, the Court held that even by a process of harmonious construction, RERA and the code must be held to co-exist and, in event of clash, RERA must give way to the Code. RERA, therefore, cannot be held to be a special statute, which, in case of conflict, would override the general statute, the Code.

In concluding remarks as far as the Code v RERA is concerned, the Court has stated as under:

As a matter of fact, the Code and RERA operate in completely different spheres. The Code deals with a proceeding in rem in which the focus is the rehabilitation of the corporate debtor. This is to take

place by replacing the management of the corporate debtor by means of a resolution plan which must be accepted by 66% of the Committee of Creditors, which is now put at the helm of affairs, in deciding the fate of the corporate debtor. Such resolution plan then puts the same or another management in the saddle, subject to the provisions of the Code, so that the corporate debtor may be pulled out of the woods and may continue as a going concern, thus benefitting all stakeholders involved. It is only as a last resort that winding up of the corporate debtor is resorted to, so that its assets may be liquidated and paid out in the manner provided by Section 53 of the Code. On the other hand, RERA protects the interests of the individual investor in real estate projects by requiring the promoter to strictly adhere to its provisions. The object of RERA is to see that real estate projects come to fruition within the stated period and to see that allottees of such projects are not left in the lurch and are finally able to realise their dream of a home, or be paid compensation if such dream is shattered, or at least get back monies that they had advanced towards the project with interest. At the same time, recalcitrant allottees are not to be tolerated, as they must also perform their part of the bargain, namely, to pay instalments as and when they become due and payable. Given the different spheres within which these two enactments operate, different parallel remedies are given to allottees – under RERA to see that their flat/apartment is constructed and delivered to them in time, barring which compensation for the same and/or refund of amounts paid together with interest at the very least comes their way. If, however, the allottee wants that the corporate debtor's management itself be removed and replaced, so that the corporate debtor can be rehabilitated, he may prefer a Section 7 application under the Code. That another parallel remedy is available is recognised by RERA itself in the proviso to Section 71(1), by which an allottee may continue with an application already filed before the Consumer Protection fora, he being given the choice to withdraw such complaint and file an application before the adjudicating officer under RERA read with Section 88….

Conclusion:

The above judgment of Supreme Court makes it clear that the provisions of RERA should give way to the provisions of IBC, when there is a clash among them. This judgment gives more strength to the home buyers who were ill-treated/duped/deceived by the disgruntled developers to this time. No doubt, at the same time, it would be hard pill for digestion for a genuine developer, but in our opinion, if the main objective of a home buyer is to get his flat/apartment, then invoking the code is the last resort. There are necessary safeguards built in the Code to see that the genuine developer is not kept away from the business. Hope, the home buyers would use the Code only in the extreme of the extreme case and not every now and then.