

Consumers as Creditors in Corporate Insolvency

by Aparna Ravi

August 3, 2018

SAMVĀD:
PARTNERS

Home Buyers under the IBC

- *What does the classification of home buyers as financial creditors do to the framework of the IBC and the distinction between operational and financial creditors?*
- *Can/should the IBC be used to solve consumer concerns? What effect would this have on incentives?*

Distinction between Financial and Operational Creditors

- Rationale for Distinction:
 - Financial creditors more likely to be able to assess financial viability/be involved in the resolution process, agree for restructuring
 - Secured v. unsecured to Financial v. Operational creditors - IBC makes less of a distinction between secured and unsecured creditors for the resolution process; distinction between operational and financial creditors also intended to bring unsecured financial creditors on equal footing with secured financial creditors
- Grey Areas:
 - Supply chain finance/Bill discounting – what happens when a bank/financial institution is assigned operational debt?

Where Do Consumers Fit in?

- NCLT Principal Bench dismissed number of operational creditor applications filed by homebuyers against real estate developers on the grounds that homebuyers did not fall into the narrowly construed definition of operational debt as a claim in relation to the provision of goods or services or employment and government dues.
- *Nikhil Mehta v. AMR Infrastructure Limited* (NCLT Delhi, January 23, 2017), the applicant homebuyer successfully sought to bring the defaulted debt within the ambit of financial debt under the Code.
 - Tribunal's reasoning largely based on particularities of the contract – assured returns
- Possibility of some creditors being neither operational nor financial creditors

Case of Jaypee Infratech

- Supreme Court did not grant the homebuyers' prayers (a) to stay the insolvency proceedings pending resolution of homebuyers' actions in consumer court or (b) to be treated as secured creditors, on par with banks and financial institutions,

BUT

- Ordered resolution professional to come up with a resolution plan that protected the interests of homebuyers and secured creditors; and ordered Jaypee Associates (parent of Jaypee Infratech) to deposit Rs 2,000 crores with the Court to protect homebuyer interests.

While operational creditors and consumers don't have significant rights under the IBC, courts and the NCLT are likely to step in to protect their interests

October amendments to CIRP Regulations requires resolution plan to state "how it has dealt with the interests of all stakeholders, including financial creditors and operational creditors, of the corporate debtor."

Homebuyers as Financial Creditors

- *Do consumers deserve special protections under the IBC?*
- *Are homebuyers a special class of consumers that deserve special protections under the IBC?*
- ILC Report – Considers the second question and tries to fit homebuyers into the definition of financial creditors
 - Advances paid by homebuyers form a significant chunk for construction of new developments; in this sense the homebuyers are financing the construction of their homes by the developer
 - Tries to fit advances paid by homebuyers into the definition of “financial debt” - if the home is not completed or completed late, homebuyers receive payments akin to interest payments for the time value of money.

Home Buyers as Financial Creditors

- But, is this the commercial reality?
- Home buyers are not in the business of financing development projects
- Goal is not recovery of the debt advanced, but their homes
- Appear more similar to consumers who make prepayments than financial creditors

Blurring the Line Further

- Opening the floodgates to other consumer creditors – challenge as to why home buyers are treated differently from other consumer?
- What is this likely to do to real estate insolvencies? Will the resolution process get more unwieldy in light of banks/financial institutions and home buyers being on the CoC?

Availability of Other Remedies

- IBC is not a consumer protection legislation
- Insolvency means there isn't enough for everyone – if more and more groups tend towards the IBC to resolve their concerns, it reduces the effectiveness of its initial goal, which is to aid resolution and recovery
- Insolvency is a choice of last resort – remedies under other legislation, including consumer protection legislation, come in much earlier in the process. Would making home buyers financial creditors give them an incentive not to pursue other remedies earlier on?

Suggestions

- Consider looking into real estate sector in cross country comparison
- Can some consumer advances be fit into financial debt?
- What if the IBC were to have no creditor classification?

Questions?

Thank You

aparna@samvadpartners.com