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Do the real estate creditors have shelter under the Insolvency and Bankruptcy Code, 2016?

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Background

India is ranked at 136th out of 189 countries in the World Bank's index on the ease of resolving insolvencies. The ranking was destined to be a wakeup call and the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "the Code") was a result of such urgency. With the introduction of this enactment, there is a hope for much needed clarity on liquidation proceedings of Indian corporates.

The Code is expected to impact the real estate sector as well. According to a report in 2015, the Non-Performing Assets (NPAs) in real estate sectors were worth Rs 6,000 crore. There are several developers who have for various reasons delayed repayments of loan. An application against such defaulting developers can be filed by the creditors.

The real estate sector will come under the purview of the Real Estate (Regulation and Development) Act, 2016 (hereinafter referred to as "RERA") and the said property will come under the jurisdiction of the regulatory authority and be bound by the rules applicable to the sector. The buyer as a result may not be adversely affected as RERA is "buyer-friendly".

In this article, we intend to analyse the impact of the Code on the real estate sector. There have been cases filed by the creditors of the real estate company in NCLT for admission of application as creditors under the Code for the purpose of initiation of corporate insolvency resolution process against the developer.

Here, the pertinent question of law is the fact that whether any deprived creditor can file an application as financial creditor under the Code? The same has been elaborated herein.

In the recent case of *Nikhil Mehta and Sons (HUF) V M/s AMR Infrastructures Ltd*¹, the Principal Bench of the National Company Law Tribunal (NCLT) – New Delhi, after deliberating at stretch has interpreted the scope of the stipulations

¹[http://nclt.gov.in/Publication/Principal_Bench/2017/Others/AMR%20Infrastructure%20Ltd.%20\(Nikhil%20Mehta\).pdf](http://nclt.gov.in/Publication/Principal_Bench/2017/Others/AMR%20Infrastructure%20Ltd.%20(Nikhil%20Mehta).pdf)

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i.e. Financial Creditor and Financial Debt as defined under Section 5 of the Code.

Briefs of the case

Mr. Nikhil Mehta HUF along with others (herein after referred to as “the HUF”) has entered into Memorandum of Understanding (‘MOU’) with M/s AMR Infrastructure Limited (herein after referred to as “AMR Infra”). AMR Infra is engaged into the development of commercial and residential real estate. The MOU was entered for the purpose of booking two commercial and one residential property, for which substantial payments have been made as mandated under the MOU executed. The possession of the property had to be handed over to the HUF by AMR Infra, as per the terms mandated under the MOU. As per the terms of MOU, a stipulated fixed amount i.e. ‘Assured Return’ was agreed to be paid on monthly basis by AMR Infra to the HUF in respect of all the properties as mentioned in the MOU, till the respective dates of delivering of possession of the booked properties.

Preliminarily, AMR Infra made payments to the HUF for a certain period and then defaulted in the payment of Assured Return. Upon failure of payment of the Assured Returns, the HUF issued three legal notices for the demand of Assured Return, due and payable as per terms of signed MOU. Further, none of the projects of the HUF has been completed by offering possession.

Many other creditors have been duped to invest their money in the projects of AMR Infra out of which many of them have already initiated the winding up proceedings against the Respondent which are pending in the Hon’ble High Court of Delhi.

Relief sought

The HUF sought the following reliefs:

- Upon the default being committed by AMR infra, is the HUF is a financial creditor?
- If yes, can the HUF move an application under Section 7 of the Code, read with Rule 4 and Rule 9(1) of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016?

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It is asserted before the Tribunal that the aforesaid amount i.e. “Assured Return” is an admitted debt by the Respondent and the default in payment of such debt would be sufficient to satisfy the requirement of Section 7 read with Section 5(7) and (8) of the Code i.e. would be covered by the expression Financial Creditor and Financial Debt for the application to be filed under Section 7 of the Code.

Question before NCLT

1. Whether the Applicant to be considered as a Financial Creditor for the purpose of the Insolvency process as per Code?
2. Whether the ‘Assured Return’ to be paid as per MOU, qualifies to be considered as the Financial Debt and its non-payment is a default for the institution of Insolvency process?

Status of the matter

Since the counsel for Applicants has not been able to prove that the aforesaid transaction is a financial transaction in which a debt has been disbursed against the consideration for the time value of money and the applicants being financial creditor is entitled to trigger the insolvency process under section 7 of Code, the application was dismissed.

Conclusion

The NCLT by its judgment has laid down ‘the consideration for time value of money under a Financial Transaction’ as an essential element for determination of a Financial Debt. Reference of the Commentary from, further substantiates, the amount to be paid/received under sale and purchase agreements to be carried out in future does not imparts the nature of Financial debt, it’s the financial/money transaction coupled with the interest or the compensation for time value of money which imparts the character of Financial Debt.

In the instant case, Money was paid in advance for the delivery of possession to be made in future and the “Assured Return” for the amount so advanced was not proved from the material on record as to constitute the interest on advance or the payment in reference to time value of money.

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Therefore, it is pertinent to note that since the creditor in the order is not admitted as financial creditor under the Code, no process was initiated henceforth. Care needs to be taken proceeding henceforth under the Code.

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