

# Legislative Brief

## The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018

The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 was promulgated on June 6, 2018. It amends the Insolvency and Bankruptcy Code, 2016.

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### Highlights of the Ordinance

- ◆ The Ordinance amends the Insolvency and Bankruptcy Code, 2016 to clarify that allottees under a real estate project should be treated as financial creditors.
- ◆ The voting threshold for routine decisions taken by the committee of creditors has been reduced from 75% to 51%. For certain key decisions, this threshold has been reduced to 66%.
- ◆ The Ordinance allows the withdrawal of a resolution application submitted to the NCLT under the Code. This decision can be taken with the approval of 90% of the committee of creditors.

### Key Issues and Analysis

- ◆ The rationale for classifying allottees under a real estate project as financial creditors may be questioned. Further, the Ordinance does not clarify whether allottees are secured or unsecured financial creditors. In the absence of allottees having a clear status, there may be uncertainty about their priority when receiving dues from the insolvency proceedings.

## PART A: HIGHLIGHTS OF THE ORDINANCE

### Context

The Insolvency and Bankruptcy Code, 2016 provides a time-bound process to resolve insolvency among companies and individuals. Insolvency is a situation where an individual or company is unable to repay their outstanding debt. In November 2017, the Insolvency Law Committee was set up to review the Code, identify issues in its implementation, and suggest changes.<sup>1</sup> The Committee submitted its report in March 2018.<sup>2</sup> The Committee made several recommendations such as exempting micro, small and medium enterprises from certain provisions of the code, treating allottees under a real estate project as financial creditors, reducing voting thresholds of the committee of creditors, among others. Subsequently, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018, was promulgated on June 6, 2018.

### Key Features

- **Status of allottees:** The Code defines a financial creditor as anyone who has extended any kind of loan or financial credit to the debtor. The Ordinance clarifies that an allottee under a real estate project (a buyer of an under-construction residential or commercial property) will be considered as a financial creditor, as the amount raised from allottees for financing a real estate project has the commercial effect of a borrowing.
- **Representative of financial creditors:** During the insolvency resolution process, a committee consisting of financial creditors will be constituted for taking decisions (by voting) on the resolution process. The Ordinance specifies that, in certain cases, such as when the debt is owed to a class of creditors, the financial creditors will be represented on the committee of creditors by an authorised representative. These representatives will vote on behalf of the financial creditors as per the prior instructions received from them.
- **Voting threshold of committee of creditors:** The voting threshold for decisions of the committee of creditors has been lowered from 75% to 51%. For certain key decisions of the committee, the threshold has been reduced from 75% to 66%. These include: (i) appointment of the resolution professional, (ii) approval of the resolution plan, and (iii) increasing the time limit for the insolvency resolution process.

- **Ineligibility to be a resolution applicant:** The Ordinance amends the criteria which prohibits certain persons from submitting a resolution plan. For example, the Code prohibits a person from being a resolution applicant if his account has been identified as a non-performing asset (NPA) for more than a year. The Ordinance provides that this criterion will not apply if such applicant is a financial entity, and is not a related party to the debtor (with certain exceptions). Secondly, the Code also bars a guarantor of a defaulter from being an applicant. The Ordinance specifies that such a bar will apply if such guarantee has been invoked by the creditor and remains unpaid.
- **Applicability of the Code to Micro, Small, and Medium Enterprises (MSMEs):** The Ordinance states that the ineligibility criteria for resolution applicants regarding NPAs and guarantors will not be applicable to persons applying for resolution of MSMEs. The central government may, in public interest, modify or remove other provisions of the Code while applying them to MSMEs.
- **Withdrawal of submitted applications:** A resolution applicant may withdraw a resolution application, from the National Company Law Tribunal (NCLT), after such process has been initiated. Such withdrawal will have to be approved by a 90% vote of the committee of creditors.

## PART B: KEY ISSUES AND ANALYSIS

### Classification of allottees under a real estate project as financial creditors

*Code:*  
Section  
3(30);  
Section 5,  
subsections  
7, 8, 20, 21

With regard to corporate debtors, the Code defines two types of creditors: (i) financial creditors, who have extended a loan or financial credit to the debtor, and (ii) operational creditors, who have provided goods or services to the debtor, the payment for which is due. Financial creditors could be secured or unsecured. Secured creditors are those whose loans are backed by collateral (security).

For example, person A decides to open a restaurant. He takes a loan from a bank to buy the property for the restaurant, using the property premises as the collateral. His friend B lends him some funds to manage the initial expenses, such as payment of salary to chefs and other support staff, buying produce, etc. In this example, the bank and friend B are financial creditors. The bank is a secured financial creditor since the loan is backed by a collateral (the restaurant premises), and friend B is an unsecured creditor. The chefs and staff at the restaurant are operational creditors. The supplier of produce is also an operational creditor.

*Ordinance:*  
Clause 3

The Ordinance clarifies that allottees under a real estate project will be considered as financial creditors. This would give the allottees: (i) the power to initiate a resolution process, (ii) representation on the committee of creditors, and (iii) the guarantee of receiving a certain amount in case of liquidation.

#### *Rationale for classifying allottees as financial creditors could be questioned*

The Insolvency Law Committee (2017) had noted that the amount paid by allottees under a real estate project is a means of raising finance for the project, and hence would classify as financial debt.<sup>2</sup> It had also noted that, in certain cases, allottees provide more money towards a real estate project than banks. The Ordinance provides that the amount raised from allottees during the sale of a real estate project would have the commercial effect of a borrowing, and therefore be considered as a financial debt for the real estate company (or the debtor). However, it could be argued that the money raised from allottees under a real estate project is an advance payment for a future asset (or the property allotted to them). It is not an explicit loan given to the developer against receipt of interest, or similar consideration for the time value of money, and therefore may not qualify as financial debt.

#### *Classifying allottees as financial creditors does not clarify their priority during liquidation*

*Code:*  
Section  
53(1)

During a corporate insolvency resolution process, a committee consisting of all financial creditors is constituted to take decisions regarding the resolution process. This committee may choose to: (i) resolve the debtor company, or (ii) liquidate (sell) the debtor's assets to repay loans. If no decision is made by the committee within the prescribed time period, the debtor's assets are liquidated to repay the debt. In case of liquidation, secured creditors are paid first after payment of the resolution fees and other resolution costs. This is followed by payment of employee wages, and then payment to all the unsecured creditors.

While the Ordinance classifies allottees as financial creditors, it does not specify whether they would be treated as secured or unsecured creditors. Therefore, their position in the order of priority is not clear.

1. '[Constitution of Insolvency Law Committee](#)', Order Number 35/14/2017, Ministry of Corporate Affairs, November 16, 2017.
2. [Report of the Insolvency Law Committee](#), March 2018.

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