

**TREATMENT OF RERA SECTION 4(2)(L)(D)
ACCOUNTS DURING INSOLVENCY:
CHARACTERIZATION OF HOMEBUYERS'
DEPOSITS AS CORPORATE DEBTOR'S
ASSETS AND SOLUTIONS TO PROTECT
HOMEBUYERS' INTEREST**

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ABSTRACT

The introduction of Section 4(2)(l)(D) RERA accounts under the Real Estate (Regulation and Development) Act, 2016 (RERA) has created challenges in insolvency proceedings under the Insolvency and Bankruptcy Code, 2016 (IBC). RERA requires developers to maintain three types of accounts—a Master Escrow Account, a Cash Retention Account, and a RERA-Specific Account—to ensure transparency and protect homebuyers' interests by managing funds for project completion. During insolvency, issues arise as the Interim Resolution Professional (IRP) takes control of the developer's assets, leading to

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uncertainty over whether the funds in the RERA-Specific Account should be considered part of the debtor's assets or returned to the homebuyers who deposited them.

The article highlights that the RERA-Specific account does not sufficiently protect homebuyers' interests during insolvency of the developer. This is due to lack of trust formation and creation of security interest in these accounts. This is exacerbated due to absence of any beneficiary. The deficiencies undermine RERA's protective intent since there is no beneficiary to receive the funds.

To address this problem, the authors suggest adopting statutory trust provisions from Canada's Condominium Act, of 1998. This approach creates a separate statutory trust for homebuyers' deposits, keeping these funds distinct from the developer's assets. By designating homebuyers as beneficiaries under the Canadian Bankruptcy and Insolvency Act, 1985 ensures that their deposits are protected during insolvency. The Condominium Act also provides for a tracing back mechanism to ensure that these funds are not commingled with other assets of the developer and returned to the homebuyers. Adopting these provisions would help safeguard homebuyers' funds from creditor claims, aligning with RERA's intent

and enhancing financial security for homebuyers.

Keywords: *Escrow Accounts, RERA-specific Accounts, Security Interest, Implied Trust, Fiduciary Relationship, Statutory Trust, Condominium Act.*

I. INTRODUCTION

Section 4(2)(l)(D) of the Real Estate (Regulation and Development) Act, 2016 (“RERA”) enhances transparency and accountability in the real estate sector.¹ It mandates the opening of three separate accounts: a Master Escrow Account (Collection Account), a Cash Retention Account (Promoter’s Free Project Account), and a RERA-Specific Account (RERA-compliant Separate Account). Different states use different names for these accounts. The Master Escrow Account holds 100% (one hundred percent) of the deposits by the homebuyers. Out of which, 70% (seventy percent) are deposited in the RERA-specific account which can only be used for construction and development of the project. The rest of the 30% (thirty percent) goes to the Cash Retention Account which can be utilized for other purposes.² The bank releases the funds from the RERA-specific account proportionately to the work completed, based on forms and certificates submitted by the promoters, attested by a chartered accountant, an engineer, and an architect. This provision protects homebuyers’ interests by ensuring that funds collected from them are used exclusively for the designated project, reducing the risk of fund diversion. By mandating the

¹The Real Estate (Regulation and Development) Act, 2016 (16 of 2016).

²The Tamil Nadu Real Estate (Regulation and Development) Rules, 2017, G.O.(Ms.)No.112, Housing and Urban Development (UD1(2)) Department, 22nd June 2017; Vinay Thyagraj, ‘Rera – Bankers Circular on Rera Accounts’ (*TaxGuru*, 28 February 2024) <<https://taxguru.in/corporate-law/rera-bankers-circular-rera-accounts.html>> accessed 7 August 2024.

segregation of funds into a RERA-specific account, it enforces financial discipline on developers, ensuring that resources are allocated appropriately for timely project completion. This improves project completion rates, as developers are less likely to face liquidity issues or delays due to mismanagement of funds. Additionally, it boosts overall transparency in financial transactions, allowing homebuyers to monitor the progress and financial health of the project. In cases of project cancellation or failure, this account safeguards allottees by ensuring that refunds can be provided from the funds specifically allocated for the project, addressing major issues such as financial mismanagement, project delays, and the diversion of funds in the real estate industry.

This transaction closely resembles an escrow arrangement. The Haryana Real Estate Appellate Tribunal in *Raheja Developers Limited v. Manohar Lal Kapur* affirmed that, “*in fact, this separate account, in general, and for all practical purposes, is known and referred to as ‘Escrow Account’.*”³ However, the authors will demonstrate that this characterization falls short of capturing the technicalities and has significant ramifications for homebuyers.

In a traditional escrow arrangement, three parties are involved: the buyer, the seller, and a third party, usually a bank. The bank holds the amount in trust. The bank can only release the funds once the terms and conditions of the escrow agreement are satisfied.⁴

However, the arrangement becomes complicated if the selling party becomes insolvent and the Corporate Insolvency Resolution Process

³*Raheja Developers Limited v Manohar Lal Kapur* H-REAT-437-2021.

⁴Maji P, ‘What is an Escrow account and who can use it?’ (*The Financial Express*, 30 March 2020) <<https://www.financialexpress.com/money/what-is-an-escrow-account-and-who-can-use-it/1913875/>> accessed 07 August 2024.

("CIRP") is initiated. The Interim Resolution Professional ("IRP") then assumes control of the Corporate Debtor's ("CD") assets, and a moratorium under Section 14 of the Insolvency and Bankruptcy Code, 2016 ("IBC") prevents anyone from recovering funds in the escrow account.⁵ In such situations, it is crucial to determine whether the funds in the escrow account are considered "assets" of the CD. Further, if restructuring fails and liquidation is initiated, it must be determined whether these funds will be included in the liquidation estate under Section 36 of the IBC. Assets created in "trust" for third parties are excluded from the liquidation estate. These excluded assets are not distributed among creditors but are preserved for the intended beneficiaries.

This becomes more complex when the underlying account is a RERA-specific account since its treatment will be different from typical escrow accounts, which involve three parties and create an "implicit trust", whereas RERA accounts primarily involve two parties: the bank and the developer and there is no creation of a trust as will be explained later.

In this essay, the authors will first discuss the nature of escrow accounts and how security interests can be created in such transactions. Secondly, the authors will conceptualize their treatment in insolvency situations. Thirdly, the authors will analyze the creation and treatment of Section 4(2)(1)(D) RERA accounts and explain why they fail to meet the criteria for being characterized as traditional escrow accounts. Fourthly, the authors will highlight the negative impact of this mischaracterization on homebuyers. Fifthly, the authors will draw inspiration from Canadian law on the creation of statutory trusts to safeguard homebuyers' interests and will conclude by underscoring the necessity for similar provisions to ensure the protection of homebuyers.

⁵The Insolvency and Bankruptcy Code, 2016 (31 of 2016).

I. NATURE OF ESCROW ACCOUNTS

Escrow accounts embody a fiduciary relationship wherein one party is a beneficiary and the settlor (usually a bank) holds the amount as a trustee in the beneficiary's interest. In the case of *R.B. Seth Jessaram Fatehchand v Om Narain Tankha & Anr.* ("Jessaram"), the Hon'ble Supreme Court ("SC") noted that the crucial point of differentiation to characterize a deposit as held in trust is whether the person to whom the deposit was made could mix it with his own money and use it for himself. In situations where money can only be used for certain specified purposes, as done in an escrow account, there is an implied creation of trust.⁶

Section 3(31) IBC defines a security interest as, "*right, title or interest or a claim to the property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment, and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person.*"⁷ If an agreement specifies that funds in an escrow account are released to a receiving party (e.g., a contractor or creditor) only upon meeting specific conditions, the receiving party acquires a security interest once those conditions are fulfilled. This interest arises from the right to claim the funds upon completion of obligations.

To better understand the creation of a security interest over the funds deposited in an escrow account, let us examine two scenarios: one prior to the introduction of the RERA and another after its implementation. In the pre-RERA scenario, a traditional escrow account would be set

⁶*Seth Jessa Ram Fatehchand v Om Narain Tankha* 1967 SCC OnLine SC 248.

⁷The Insolvency and Bankruptcy Code, 2016 (31 of 2016) s 3(31).

up based on the terms agreed upon by the parties involved in the transaction. However, in Section 4(2)(1)(D) RERA account, a promoter must deposit 70% (seventy percent) of the funds received from allottees in a separate account, which can only be used for construction and land costs.⁸

A. Pre-RERA – Traditional escrow account

Suppose a company, ABC Developers Pvt. Ltd. secured a loan from XYZ Finance Ltd. for its real estate projects. As security, the ABC Developers executed a deed for hypothecating 40% (forty percent) of all its receivables from the homebuyers (which will be held in a designated escrow account) in favour of XYZ Finance Ltd. In this situation, XYZ Finance Ltd. has a security interest over its proportionate receivables in the escrow account since there was the creation of a charge over the funds in exchange for the loan.

⁸RERA Filing, 'RERA Separate Bank Account Provisions' (*RERA Filing*, 7 January 2025) <<https://rerafiling.com/rera-article-detail.php/516/rera-separate-bank-account-provisions>> accessed 18 January 2025.

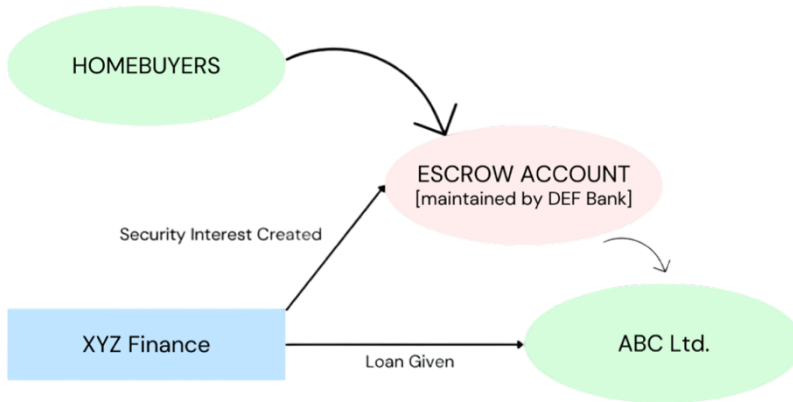


Figure 1: Traditional Escrow Account

B. Post-RERA - Section 4(2)(l)(D) of RERA Account

ABC Ltd. is undertaking a large residential project and takes pre-construction payments from homebuyers to finance the construction. As per Section 4(2)(l)(D) of the RERA, ABC Ltd. is required to open three separate bank accounts for this project. ABC Ltd. opens three separate accounts with DEF Bank as the Escrow Bank: a Master Escrow Account, a Cash Retention Account, and a RERA-Specific Account. The Master Account receives all the funds from homebuyers as instalments for their purchased units. 70% (seventy percent) of these collected funds are transferred to the RERA-Specific Account, ensuring that these funds are used exclusively for construction and land cost purposes, and the rest 30% (thirty percent) are transferred to the Cash Retention Account.

DEF Bank, acting as the trustee [escrow bank], ensures that the funds are released only upon verification of the submitted certificates. The bank regularly reports the status of the account to RERA to maintain transparency and compliance. RERA, as the third party, monitors the project's progress through periodic inspections and reports from DEF Bank. If ABC Ltd. fails to comply with the regulations or if there are discrepancies in the construction progress, RERA can take corrective actions, including freezing the funds in the RERA-Specific Account. However, as discussed next, this seemingly straightforward treatment of funds, especially in the Post-RERA scenario, gets complicated when the CIRP is initiated against the builder-developer.

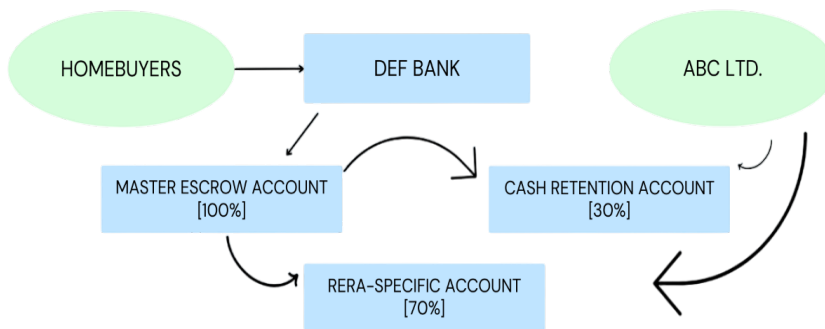


Figure 2: SECTION 4(2)(1)(D) Account

II. SITUATIONS OF INSOLVENCY

A. Treatment of Traditional Escrow Account

The treatment of traditional escrow accounts in insolvency proceedings was comprehensively addressed in *M/s. Asten Realtors Private*

Limited by the National Company Law Tribunal (NCLT), Kochi.⁹ In this matter, the Corporate Debtor (CD) had secured a ₹55 crore project loan from Piramal Capital and Housing Finance Limited (FC) for its real estate projects “Aurumwoods” and “Campus Court.” To secure the loan, the CD hypothecated all receivables to the FC through a Deed of Hypothecation and executed an Escrow Agreement on January 22, 2019, with HDFC Bank as the settlor. This agreement established multiple escrow accounts, including a Master Escrow Account, RERA Escrow Account, Distribution Escrow Account, and Cash Retention Account. Upon initiation of the Corporate Insolvency Resolution Process (CIRP), disputes arose over the use of funds in these accounts, with the Resolution Professional (RP) withdrawing funds for salaries, allowances, payments to head load workers, and CIRP costs, citing Sections 18(d), 18(f), and 22 of the Insolvency and Bankruptcy Code (IBC) to assert control over the funds as assets of the CD.

The NCLT ruled in favor of the FC, holding that the receivables in the escrow accounts, secured under the Deed of Hypothecation and Escrow Agreement, could not be considered assets of the CD. The Tribunal emphasized that pre-CIRP contractual arrangements, particularly those involving security interests, cannot be disregarded simply because CIRP has been initiated. It observed that the FC’s lien over the receivables deposited in the escrow accounts precluded their treatment as the CD’s assets. This view aligns with Section 18(f) of the IBC, which excludes from the RP’s control “*assets owned by a third party in possession of the corporate debtor held under trust or under contractual arrangements including bailment.*”

⁹*Piramal Capital and Housing Finance Limited and Ors. v Rajendran P.R. and Ors.* (05.12.2023 - NCLT - Kochi): MANU/NC/6102/2023.

This interpretation is consistent with the NCLT Hyderabad's decision in *Max Infra (I) Limited*,¹⁰ which, citing *Official Liquidator, High Court, Madras v. N. Chandranarayanan*,¹¹ recognized that funds held in escrow accounts create a fiduciary relationship and are treated as property held in trust, separate from the general assets of the company. Similarly, in *Isolux Corsan India Engineering and Construction Pvt. Ltd., v. TBEA Energy*,¹² the NCLT Chandigarh ruled that once funds are deposited into an escrow account, the CD retains only limited legal title and loses any equitable interest in the property, reaffirming that such funds are not entirely the property of the CD. The Tribunal further clarified that in transactions involving escrow accounts, the ownership of funds is transferred to the secured party as soon as the security interest is created, and the receiving party gains a charge over the money upon fulfilling the stipulated conditions.

Applying these principles, the NCLT Kochi concluded that the FC's lien over the escrow funds meant the CD had no ownership or control over them, and the RP could not treat them as assets of the CD under Section 18(f). This judgment underscores the sanctity of pre-CIRP contractual arrangements and reaffirms the protection of secured creditors' rights, ensuring that funds held in escrow accounts under fiduciary or security arrangements are excluded from the ambit of CIRP.

US case law provides for a similar treatment of escrow funds during insolvency. The U.S. Bankruptcy Court of the District of New Jersey *In Re Arrow Mill Development Corp.* held that the escrow agents [*the escrow bank in our case*] and the grantors [*homebuyers in our case*]

¹⁰*Max Infra (I) Limited, In re* IA. No. 350 of 2021.

¹¹*Official Liquidator, High Court, Madras, representing Manasuba and Co. (P) Ltd. in liquidation v N. Chandranarayanan* 1972 SCC Online Mad 158.

¹²*Isolux Corsan India Engineering and Construction Private Limited through its Liquidator CA Rajeev Bansal v TBEA Energy India Private Limited*, IA (I.B.C) - 1002/2023.

hold equitable interest in the escrow funds till the escrow conditions are fulfilled and in situations of insolvency, pre-fulfilment, the said funds will *not be* treated as Debtor's property under Section 541 of the Bankruptcy Code since the debtor holds only a bare legal title in the funds till the conditions are fulfilled.¹³ The Court notes that this is followed in real estate transactions [*accord Zaremba v. Konopka*].¹⁴

B. Treatment of Section 4(2)(l)(D) of RERA Account

However, the treatment of Section 4(2)(l)(D) RERA Account will differ during CIRP. To date, no developers have faced insolvency where the IRP claimed the funds in RERA-specific escrow accounts as 'assets' of the CD with other parties asserting rights over these funds.

An examination of the nature of these accounts, alongside the principles governing the creation of security interests and trusts—similar to those in traditional escrow accounts—highlights important concerns. These concerns specifically relate to the treatment of RERA-specific accounts in the context of insolvency proceedings.

a) Creation of Security Interest

Although some states have clarified that no security interest can be held over these accounts, it is important to understand the reasoning behind this decision. In India, the creation of a security interest involves more than just establishing a charge; it also requires 'perfection'. Perfection of security refers to the process of completing legal formalities to ensure that a creditor's claim against a debtor's assets is enforceable and recognized ahead of competing claims in case of insolvency or

¹³*In Re Arrow Mill Development Corp.*, 185 BR 190.

¹⁴*Accord Zaremba v Konopka*, 94 N.J. Super. 300, 228 A.2d 91 (Ch. Div. 1967).

liquidation.¹⁵ Without perfection, recovery becomes challenging. Regulation 21 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 requires at least one of the three compliances for perfection of the charge:¹⁶

- a. Registration with Information Utility as per Section 215(2) of the IBC and Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017.
- b. Registration of charge with Registrar of Companies as per Section 77 of the Companies Act, 2013.
- c. Registration with Central Registry of Securitisation Asset Reconstruction and Security Interest of India as per Section 26D of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (“SARFAESI Act”)

Meeting any one condition will make the charge legally enforceable. However, failing to fulfil even one condition will render the charge ineffective till the completion of the necessary perfection actions (subject to payment of the penalty, if any).

Registration with any of the three entities requires the existence of a ‘security interest’. Under the IBC and SARFAESI Act, security interest encompasses rights, titles, or interests such as mortgages, hypothecation, or assignments.¹⁷ Therefore, we must also analyse if there is the creation of any security interest over these funds.

¹⁵Maheshwari N, Mairal D and Bansal P, ‘Perfection of Security Interest’ (*AZB*, 18 October 2021) <<https://www.azbpartners.com/bank/perfection-of-security-interest/>> accessed 7 August 2024.

¹⁶Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.

¹⁷The Insolvency and Bankruptcy Code, 2016 (31 of 2016) s 3(31); The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002) s 2(zf).

i. Do homebuyers have a security interest?

Section 18 of RERA grants allottees the right to claim refunds and compensation. Nevertheless, per NCLAT judgments in *Flat Buyers Association Vs. Umang Realtech Pvt. Ltd.*,¹⁸ and *Rajesh Goyal Vs. Babita Gupta*,¹⁹ homebuyers are considered unsecured creditors since they have rights over the flats but not the funds in the escrow account. In contrast, secured creditors such as banks may have rights over the funds, not the flats. Even as per Section 40 of RERA, after the allottees are issued Recovery Certificates (“RCs”) for refund and compensation, and then the amount is recovered as per the land revenue codes and not from the escrow accounts.²⁰ Moreover, as per Section 3(31) of the IBC, the security interest is created in favour of secured creditors, therefore excluding homebuyers from the ambit.

ii. Do developers have a security interest?

Initially, it might seem that developers have a security interest over the funds since these are released from the Section 4(2)(L)(D) Account in proportion to the work completed, similar to a traditional escrow account. However, real estate developers occupy a unique position when it comes to their standing vis-à-vis the homebuyers. In *Pioneer Urban Land and Infrastructure Limited v. Union of India*, the SC clarified that,

¹⁸*Flat Buyers Association v Umang Realtech Pvt. Ltd* (2020) SCC OnLine NCLAT 1199.

¹⁹*Rajesh Goyal v. Babita Gupta* (2021) SCC OnLine NCLAT 533.

²⁰*Newtech Promoters and Developers (P) Ltd. v State of U.P.* 2021 SCC OnLine All 858.

“Here again, what is unique to real estate developers vis-à-vis operational debts, is the fact that, in operational debts generally, when a person supplies goods and services, such person is the creditor and the person who has to pay for such goods and services is the debtor. In the case of real estate developers, the developer who is the supplier of the flat/apartment is the debtor inasmuch as the home buyer/allottee funds his own apartment by paying amounts in advance to the developer for construction of the building in which his apartment is to be found.”²¹

As per Section 3(31) of the IBC, only creditors can possess security interest against the debtors and not vice-versa. Consequently, the developers cannot hold any security interest over the escrow account funds paid by the homebuyers.²²

Since neither homebuyers nor developers have a security interest in the escrow account funds, and the RERA authority and the bank act as the monitoring authority and the settlor respectively, there can be no perfection of the charge since there is no security interest. As a result, no party can claim a lien over these funds during insolvency or liquidation.

²¹*Pioneer Urban Land and Infrastructure Ltd. v Union of India* (2019) 8 SCC 416.

²²The Insolvency and Bankruptcy Code, 2016 (31 of 2016) s 3(31).

Recently, in a slew of circulars, Maharashtra,²³ Uttar Pradesh,²⁴ Haryana,²⁵ Rajasthan,²⁶ Karnataka²⁷, and other RERA authorities have also clarified that the separate accounts are 'no-lien' accounts.

b) Creation of a Trust?

Escrow accounts require the existence of a trust arrangement.²⁸ The Indian Trusts Act, of 1882 ("Trust Act") defines a trust as, "*an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.*"²⁹

Trust can be express or implied/constructive.³⁰ An implied trust does not require an express declaration to the effect but requires the holding of property by one party who is in a fiduciary relationship with the other party.³¹

²³Discussion Paper in the matter of maintenance and operation of Bank Accounts of registered real estate projects, MahaRERA/Secy/129/2024; MahaRERA, Order No. 56/ 2024.

²⁴Real Estate Project (Maintenance and Operation of Project Bank Accounts) Directions, 2020 as revised in November 2023, No. H297/Separate Account/F&A/2023-24.

²⁵Direction to the builders/promoters with regard to opening of bank accounts as per provisions of RERA, No. 1/RERA GGM Directions 2019.

²⁶The Rajasthan Real Estate Regulatory Authority Regulations, 2024, S.O.576.

²⁷The Karnataka RERA Bank Account Directions, 2020, No. RERA/Finance-Section/BAD/02/2020-21.

²⁸*Global Trust Bank Ltd. v Kakateya Cement Sugar and Industries Ltd., Hyd.*, (2000) SCC OnLine AP 533.

²⁹The Indian Trusts Act, 1882 (2 of 1882).

³⁰*Jaypee Kensington Boulevard Apartments Welfare Association v NBCC (India) Ltd* (2021) SCC OnLine SC 253 (India).

³¹*DLF Universal Ltd. v Arjun Singh* (1985) SCC OnLine Del 425.

In *Jessaram*, the SC identified the elements required to characterize a security interest as a trust. These include clear terms indicating a trust relationship or circumstances showing that money was held by a party for a specific purpose. Additionally, it must be agreed, either implicitly or explicitly, that the relationship between the parties is that of trustee and author, not debtor and creditor.

Further, in the case of *Isolux Corolan*, citing the Delhi High Court case of *Deutsche Trustee Company Ltd. Vs. Tulip Telecom Limited*³² further referring to *Reserve Bank of India v. Bank of Credit and Commerce International, Overseas Ltd.*, the NCLT clarified the creation of implied trusts in escrow accounts:

*“if an applicant makes a specific deposit with the bank for a specific purpose and the amount is earmarked or segregated in the business of commercial sense of the term though not in the physical sense of the term, the presumed relationship of debtor and creditor is rebutted. It follows that in such cases the bank is the custodian of the amounts entrusted to it in a fiduciary capacity and such amounts are impressed with trust. In such a case, the relationship constituted between the bank and the customer is that of bailor and bailee, trustee and beneficiary.”*³³

Therefore, *sensu lato*, escrow agreements imply the creation of a trust where the beneficiary has a right over the trust property and the bank is the trustee.

However, the situation is different for Section 4(2)(1)(D) RERA-specific accounts. Although the money is for a specific purpose,

³²*Deutsche Trustee Company Ltd. v. Tulip Telecom Limited* (2017) SCC Online Del 11012.

³³*Reserve Bank of India v Bank of Credit and Commerce International Overseas Ltd* (1992) SCC OnLine Bom 528.

namely construction, and land, and the bank acts as a trustee with no claim over the funds in the escrow account, the challenge lies in identifying the 'beneficiary'.

For creation of the trust, there must be a beneficiary with a right over the trust property to complete the transaction. Essentially, the beneficiary must have a security interest over the property and must gain ownership rights over the property to be termed as a 'beneficial interest' as defined under Section 3 of the Trust Act.

The SC in *State Bank of India v. Special Secretary Land & Land Revenue & Reforms & Land & Land Utilisation Deptt. of W.B. and Ors.* clarified that Section 3 of the Trusts Act,³⁴ requires the beneficiary to have a right to obtain his beneficial interest or interest against the trustee as owner of the trust property.³⁵

Further, in the case of *Ahmed Abdulla Ahmed Al Ghurair v. Star Health & Allied Insurance Co. Ltd.*,³⁶ the SC referring to *Mount Royal/Walsh Inc. v. Jensen Star, The Ship (Mount Royal/Walsh Inc. v. Jensen Star, The Ship)*, noted that, "beneficial owner serves to include someone who stands behind the registered owner in situations where the latter functions merely as an intermediary, like a trustee, a legal representative or an agent."³⁷ Hence, without an identifiable beneficiary who can step in the shoes of the owner, the essence of the trust is lost.

³⁴The Indian Trusts Act, 1882 (2 of 1882) s 3.

³⁵*State Bank of India v Special Secretary Land & Land Revenue & Reforms & Land & Land Utilisation Dept. of W.B. and Ors.* (1988) SCC OnLine Cal 85.

³⁶*Ahmed Abdulla Ahmed Al Ghurair v Star Health & Allied Insurance Co. Ltd.* (2019) 13 SCC 259.

³⁷*Mount Royal/Walsh Inc. v Jensen Star, The Ship [Mount Royal/Walsh Inc. v Jensen Star, The Ship* (1990) 1 FC 199 (Can. FC)].

Contrarily, as explained above, in case of accounts established under Section 4(2)(1)(D), homebuyers have no ‘beneficial interest’ in the funds held in the escrow account; their interest lies solely in the associated real estate properties. Neither the bank, the developer, nor the RERA authority holds any rights to these funds, as their roles are limited to being the settlor, debtor, and monitoring authority, respectively.

This was also clarified in the case *Jaypee Kensington Boulevard Apartments Welfare Association v NBCC (India) Ltd.* that, “in case of homebuyers’ issue, once homebuyers entered into an agreement with a developer and when their relations entered into turbulence and not in a position to become normal, the relation in between them will become creditor and debtor and the person under obligation shall refund the money of the homebuyers.”³⁸

However, it is important to keep in mind that once the CIRP is initiated and the moratorium begins, homebuyers lose the right to a refund as refunds are processed from the RERA-Separate and Cash Retention Account in the same proportion as they were collected.³⁹

As explained next, these accounts potentially become assets of the CD, which then fall under the control of the IRP, thereby relinquishing the right to refund.

c) Treatment of Funds

³⁸*Jaypee Kensington Boulevard Apartments Welfare Association v NBCC (India) Ltd* 2021 SCC Online SC 25 ¶59.

³⁹Haryana RERA circular (n 17) Rule 7(v); Maharashtra RERA discussion paper (n 16) Rule 3(B)(v).

Since Section 4(2)(I)(D) accounts are not true escrow accounts because no trust is created and no third party has a claim over the money, the IRP can exercise control over the funds in these accounts, considering them as 'assets' of the CD.

Although this approach deviates from past precedents, which prioritized the beneficiary's security interest over the rights of the IRP to control the funds and maintain the CD as a going concern, unfortunately, it is justified in light of the principles outlined above. Moreover, since Section 36(4) of the IBC only excludes assets held in trust for third parties, the funds in the escrow account will be included in the liquidation estate and will be distributed as per the waterfall mechanism under Section 53 of the IBC. Therefore, the escrow funds will be classified as assets of the CD.

III. NEGATIVE RAMIFICATIONS FOR HOMEBUYERS

This seemingly minor issue has serious negative ramifications for homebuyers who are already plagued by regulatory inefficiencies. Before RERA, the real estate sector lacked regulation, leading to widespread exploitation by developers. RERA was introduced to protect buyers and ensure transparency but remains ineffective as it cannot enforce orders or take strict action against developers who violate its directives. The data shows that RCs are rarely enforced.⁴⁰ Now, in insolvency situations, homebuyers will face another setback. Under Section 14 of the IBC, a moratorium is imposed, temporarily prohibiting creditors from initiating or continuing legal actions against

⁴⁰ 'Has Rera Become Toothless? Requirement of Amendment in Local Land Laws to Execute Recovery Certificates' (*VK Bansal & Associates*, 21 May 2024) <<http://www.vkbansalandassociates.com/has-rera-become-toothless-requirement-of-amendment-in-local-land-laws-to-enforce-recovery-certificates/>> accessed 7 August 2024.

the CD. Once the moratorium begins, creditors are unable to enforce their RCs, approach consumer forums, or claim refunds, as their deposits are treated as assets of the CD. Without a security interest or trust claim over these escrow accounts, they are left without any claim over their hard-earned money. These funds risk being classified as assets of the CD and subsequently disbursed among financial creditors, leaving homebuyers with no financial recourse. This misalignment not only jeopardizes the right to recovery of homebuyers but also undermines the very purpose of RERA, which is to protect their interests.

IV. TAKING CUES FROM ONTARIO SUPERIOR COURT OF JUSTICE

Comprehending Such situations are not unique to India and have arisen in other jurisdictions as well. One such example is Canada, where similar concerns led to the implementation of legislative measures and judicial decisions to address these challenges. Parallels can be drawn to the Indian context, highlighting mechanisms designed to protect vulnerable parties such as homebuyers.

A potential solution can be drawn from a conjunctive reading of Section 67(1)(a) of the Bankruptcy and Insolvency Act of 1985 (“BIA”)⁴¹ and Section 81 of the Condominium Act of 1998 (“Condominium Act”) provides valuable insights into safeguarding homebuyers’ interests in real estate transactions.⁴²

Section 67(1)(a) of the BIA is similar to Section 36(4) of the IBC insofar as it excludes “*property held by the bankrupt in trust for any other person*” from the estate of the bankrupt.

⁴¹The Bankruptcy and Insolvency Act (R.S.C., 1985, c. B-3) (Canada).

⁴²The Condominium Act, 1998 (Canada).

Complementing this protection, Section 81 of the Condominium Act requires developers to hold all payments made by prospective homebuyers in trust. These payments, whether made as deposits, reservations, or part of the purchase price for a proposed unit, must be safeguarded by a trustee or the developer's solicitor. This provision ensures that the financial contributions of homebuyers are protected from the insolvency risks faced by developers and prevents these funds from being included in the developer's general assets.

It mandates that all money received from homebuyers be held in trust by a trustee or the declarant's solicitor. This provision creates a 'statutory trust' ensuring that homebuyers' deposits are segregated and safeguarded, preventing commingling with other assets of the bankrupt. The intent behind this statutory trust is to protect the financial interests of homebuyers in insolvency situations.⁴³

Canadian law further protects these deposits through the concept of 'tracing back', which obliges the receiver (akin to the IRP in India) to restore misdirected or commingled funds to the statutory trust, ensuring they are returned to the homebuyers in insolvency situations.⁴⁴ This mechanism provides an additional layer of security, guaranteeing that even if funds are mistakenly or fraudulently moved, they can be traced and recovered.

Further, Section 81(4) reads:

“(4) Upon receiving money that is required to be held in trust under subsection (1), a trustee of a prescribed class shall hold the money in trust in a separate account in Ontario designated as a trust account

⁴³*Ward-Price v Mariners Haven Inc* (2001) 57 OR (3d) 410.

⁴⁴*ibid* 24.

at a bank listed in Schedule I or II to the Bank Act (Canada), a trust corporation, a loan corporation or a credit union.”

Section 81(4) of the legislation requires that these trust monies be held in a separate account, analogous to Section 4(2)(1)(D) of RERA. This ensures that the funds are easily identifiable and accessible, reducing the risk of mismanagement.

The statutory trust created under Section 81 of the Condominium Act resolves the key issue of identifying the beneficiary by explicitly recognizing the purchaser as the beneficiary of funds held in trust. This ensures that homebuyers are not treated merely as unsecured creditors in the event of insolvency but are instead granted the protections afforded to beneficiaries under trust law. The Ontario Court of Appeal in *Ward-Price v. Mariners Haven Inc.* explained that this statutory trust goes beyond a simple debtor-creditor relationship, providing homebuyers with additional remedies available under trust law, including actions for breach of trust.⁴⁵

Most importantly, the Condominium Act endows homebuyers with “*an absolute equitable interest in the purchase money.*”⁴⁶ In *Isolux Corolan*, the reason for disallowing the IRP from using escrow account funds was that “*once the fund becomes part of the Escrow Account, any creditor or debtor holds on to the money only to the extent of its legal title and not to the extent of any equitable interest in such property that the said person does not hold.*”⁴⁷ Therefore, once statutory trusts are made in favour of the homebuyers, the homebuyers have an equitable interest in the deposits which means that homebuyers have a direct and enforceable right to their deposits, which cannot be overridden by other creditors’ claims.

⁴⁵*ibid* (n 32).

⁴⁶*ibid* (n 21) (n 32).

⁴⁷*Isolux Corsan* (n 10) [19].

Most recently, the Superior Court of Justice of Ontario, in a cross-motion in the case of *Atrium Mortgage Investment Corporation and Dorr Capital Corporation v. Stateview Homes (Nao Towns II) Inc.*, 2024,⁴⁸ reaffirmed the application of these relevant provisions and practices. In this case, homebuyers' deposits, which were intended to be held in trust, were commingled by the receiver. The receiver argued that the properties were sold as freehold properties [property where the owner owns the land and the building] and not as Common Elements Condominiums ("CEC") [*akin to flats in India, where flat owners share common rights to areas such as the roof, staircases, and other shared spaces within the property.*], thereby falling outside the scope of the Condominium Act and not requiring the funds to be held in trust, making them available for distribution among secured creditors. However, the Court of Appeal held that the money was used for the development of the projects, thus becoming part of the funds protected under the statutory trust. The Court emphasized that a mere technical contractual clause cannot alter the fundamental nature of the transaction, which involved CEC properties, akin to flats in India, and not just freehold properties. Consequently, the receiver was required to trace back the deposits and withhold the funds from being distributed among other creditors, ensuring they were returned to the homebuyers. The Court of Appeal summarized and reiterated the position that "*if the Homebuyers can establish that a valid trust was established in respect of the Deposit Funds for the purposes of the BIA, then their interest in those funds (and any property they trace into) rank ahead of the interests of the Debtors' secured creditors.*"⁴⁹

⁴⁸*Atrium Mortgage Investment Corporation and Dorr Capital Corporation v Stateview Homes (Nao Towns II) Inc.* Court File No. CV-23-00698395-00CL.

⁴⁹*ibid* (n 33).

The analysis underscores the importance of recognizing homebuyers' equitable interest in their deposits, which should supersede the claims of secured creditors. The Condominium Act's consumer-oriented focus and the protection it offers can serve as a model for legislative reform in India. By adopting similar statutory trust provisions, RERA can better fulfil its objective to safeguard homebuyers, ensuring their deposits are protected during insolvencies.

Implementing such a statutory trust system under RERA would address the current gaps in the classification of the homebuyer's deposits in RERA-specified account funds as assets of the CD. This would provide a clear legal mechanism for the segregation, management, and recovery of these funds, thereby enhancing homebuyer confidence in the real estate sector.

V. CONCLUSION

BITs We have analyzed the potential treatment of Section 4(2)(1)(D) RERA accounts in a CIRP. While these accounts resemble a traditional trust account, which is typically excluded from CD's assets and the liquidation estate, a detailed analysis reveals that these accounts do not meet the criteria of being designated as trust accounts. This is primarily because they lack a defined beneficiary with a security interest over the funds, and no charge can be created on these funds. Consequently, these accounts are classified as assets of the CD under the IBC.

With this classification, the IRP, under Sections 17 and 24 of the IBC, can assert control over these funds during insolvency proceedings. This represents a departure from traditional precedents, where escrow accounts for third-party beneficiaries were excluded from the CD's assets. Such classification disrupts the recovery rights of homebuyers, leaving them with minimal prospects as unsecured creditors during distribution. This shift is significant, as it prioritizes maintaining the CD's assets within the liquidation estate over protecting third-party

interests, including those of homebuyers. This unintended misclassification places homebuyers in an especially vulnerable position. As unsecured creditors, they rank lower in the waterfall mechanism and may not recover their dues, despite being the most critical stakeholders in real estate transactions. The situation exacerbates their financial insecurity, undermining the protective intent of RERA.

To address these shortcomings, we propose adopting the statutory trust provisions found in Ontario's Condominium Act of 1998. These provisions establish a statutory trust for homebuyers' deposits, ensuring their segregation and protection from the developer's general assets, especially in situations of insolvency. Additionally, the framework includes a tracing mechanism that allows for the recovery of misdirected funds to the statutory trust. By designating homebuyers as beneficiaries with an equitable interest in these deposits, the Ontario model provides robust safeguards for their funds.

Therefore, while RERA-specific accounts uphold transparency and accountability in real estate transactions, India must strive to emulate Ontario's model. Such reforms are essential to ensure that homebuyers' deposits are adequately protected, aligning with RERA's protective objectives and reinforcing confidence in the real estate sector.