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DIFFERENTIAL TREATMENT OF OPERATIONAL CREDITORS UNDER IBC: AN UNFAIR CODE?

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DECLARATION

I hereby declare that the Dissertation titled “**DIFFERENTIAL TREATMENT OF OPERATIONAL CREDITORS UNDER IBC: AN UNFAIR CODE?**” is submitted by **Vinay Sachdev**, a student of BBA LL.B. Final Year in the requirements for the award of the degree of bachelor of Law is based on my original research work and this work has been done under the supervision and guidance of **Assistant Professor Saksham Mishra**

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DATE- 23-03-2024

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This task was effective because of the attitudes of the people that are close to me. As a result, I respect their honesty, faith, and trust.

Second, I would like to thank someone for helping the dissertation become a success. Your prior knowledge, robust scientific methodology, and endearing nature substantially influenced the results of this dissertation. My appreciation is sent to the instructors and friends for their help, advice, talks, and theoretical exchanges. I am grateful to Assistant Professor Saksham Mishra for your genuine interest in the research issue, for letting me visit your office at any time, for letting me approach this project in my own way, and for giving me the support and direction I needed.

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I express my gratitude to all of you for your guidance during the dissertation writing process and for this publication. I've had help from several friends. I appreciate the assistance from those that greeted me. This dissertation has also benefited from the contributions of domestic friends and family.

Last but not least, I would want to express my appreciation to the writers of the numerous books, articles, and journals that I have used as a reference while conducting my research.

Date: 23-03-2024

CHAPTER 1

INTRODUCTION

1.1 Introduction

The Insolvency and Bankruptcy Code, 2016 (IBC) has consolidated and revised the laws governing the reorganisation and insolvency of corporate persons, partnership firms, and sole proprietorships. The primary purpose of this legislation is to assist the timely resolution of corporate insolvency. The 2013 Companies Act simply introduced the phrase “creditors” without providing any clarification. The Insolvency and Bankruptcy Code, 2016 classifies creditors as ‘financial’ and ‘operational’ for the sake of transparency. In addition, this classification under the IBC has been utilised to place creditors on different tiers at each step of the proceedings; consequently, it is essential that creditors understand the scope of their rights under the Code.

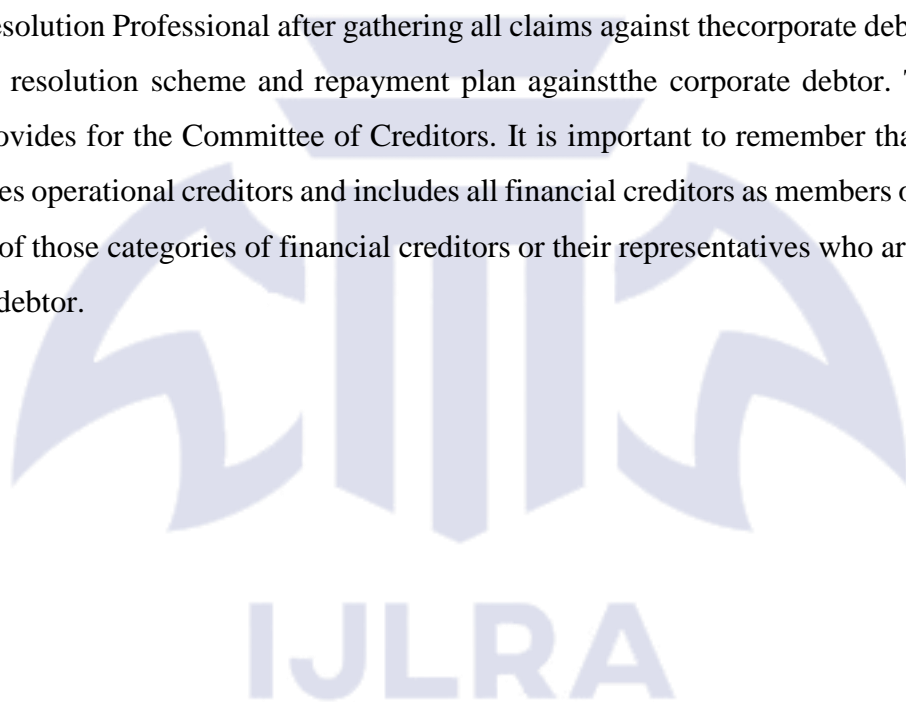
Two fundamental components of the insolvency procedure under the IBC, 2016 are a financial creditor and an operational creditor. The 2016 Code distinguishes between financial and operational

creditors. Financial creditors are those who have a purely financial contract with the entity, such as a loan or a debt security. Operational creditors are those whose obligation to the firm emerges from an operation-related transaction. According to the study, the IBC also addresses circumstances in which a creditor has conducted both financial and operational transactions with an organization. Under these conditions, the creditor may be categorised as a financial creditor for the amount of the financial debt and an operational creditor for the amount of the operational debt.

The Code establishes a number of distinctions in the treatment provided to them, including, but not limited to,

1. the right to apply to NCLT (scope of adjudication),
2. the right to participate in the Committee of Creditors (the “CoC”),
3. the right to receive funds under the Resolution Plan, and (iv) the right to benefit from the liquidation of the Corporate Debtor.

As we approach Section 21 of the Code, the financial creditors have sufficient authority over the operational creditors. This is so that the Committee of Creditors, which is established by the Insolvency Resolution Professional after gathering all claims against the corporate debtor, can vote on an insolvency resolution scheme and repayment plan against the corporate debtor. This is because Section 21 provides for the Committee of Creditors. It is important to remember that Section 21(2) clearly excludes operational creditors and includes all financial creditors as members of the CoC, with the exception of those categories of financial creditors or their representatives who are affiliated with the corporate debtor.



It is very clearly understood that an operational creditor is not eligible to join the CoC and is not given the aforementioned authority. Additionally, Section 24(3)(c) places restrictions on the right of an operational creditor to attend such a CoC meeting. It states that those operational creditors whose cumulative debts total at least 10% of the total debt due from the corporate debtor may attend the CoC meeting but not participate or vote as permitted by Section 24(4), and their absence will not have any bearing on the proceedings of the succeeding CoC meeting.

In addition, a specific order of priority has been enlisted under Section 53 of the Code for the distribution of liquidation assets that are owed to the corporate debtor in line with such order. According to Sections 53(2)(b)(ii) and 53(2)(d), the secured financial creditor is given due prominence and importance, followed by the unsecured creditors, among both secured and unsecured financial and operational creditors, while obligations owed to operational creditors are impliedly interpreted as “any remaining debts and dues” and are given relatively less prominence under Section 53(2)(f).

The ultimate purpose of every creditor, whether financial or operational, is to maximize recovery. The IBC contains no incentive mechanism to encourage such a transition and ensure that financial creditors do not act only in their own self-interest. Despite the fact that the current legal environment has been able to settle disputes in terms of prompt payment of resolution amount and discriminatory nature of the resolution, the war is far from finished.

As we delve deeper into the scenario, we discover that neither clarity nor rule is available to help the IBC framework in answering issues about the procedure for distributing the resolution amount. (Unlike distribution of liquidation value, since Section 53 cannot be relied upon in a resolution process) whether equally or pro-rata between the Financial and Operational Creditors or whether the Operational Creditors may also be conferred with the power to participate with the CoC (Financial Creditors) in granting certain Section 28 approvals that would otherwise have a direct impact on the interest of the Operational Creditors had they been oppressed by the CoC.

1.2 Research Questions

1. Whether vesting near-plenary control of the Corporate Resolution Insolvency Process (CIRP) with a Committee of Creditors made up of financial creditors has led to a perception of inequitable distributions between the classes of creditors?
2. Whether the CIRP provisions of the IBC are inconsistent with public policy to the extent that they were construed to fail to protect vested charges of secured creditors?
3. Whether the CIRP provisions and the accompanying Insolvency Resolution Regulations fall short of the standards of procedural fairness?

1.3 Hypothesis

1. Vesting near-plenary control of the CIRP with Financial Creditors may cause inequitable distributions between the class of Financial Creditors and the class of Operational Creditors.
2. The CIRP provisions of the IBC are inconsistent with public policy to the extent that they have been construed to fail to protect vested charges of Secured Creditors.
3. The CIRP Provisions and CIRP Regulations fall short of the standards of procedural fairness.

1.4 Research Methodology

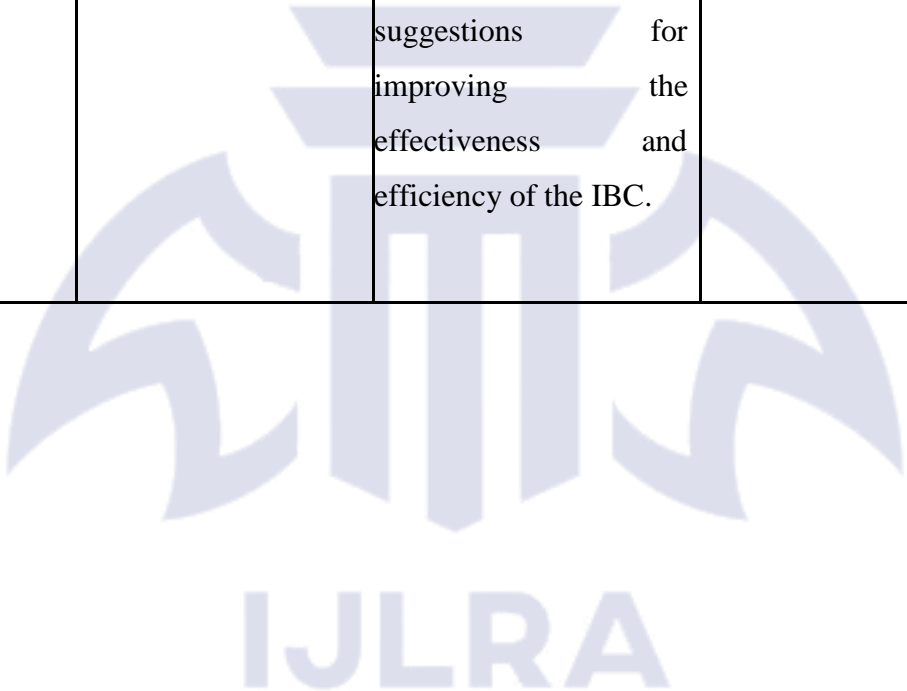
The Dissertation is based on doctrinal research.



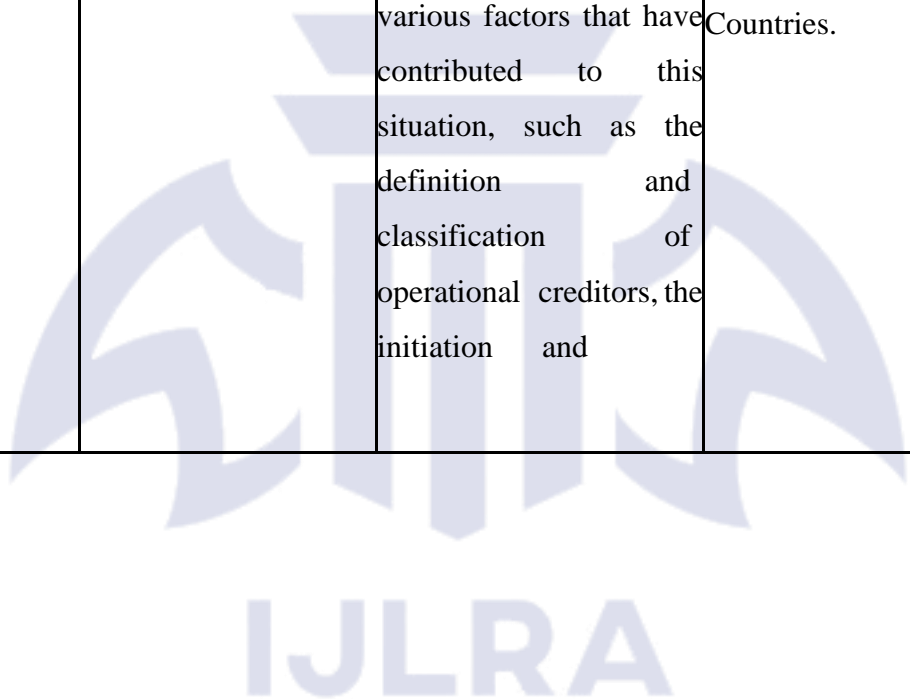
1.5 Literature Review

Sr. No.	Nature of Literature	Name of Literature	Covered/Review	Research Gap in Literature	Intended Research
01	Research Paper	Interpretation of Financial Creditor and Operational Creditor by Riya Jain	The author discusses the interpretation of financial creditors and operational creditors in relation to the relevant provisions and some judicial pronouncements under the IBC. The paper analyzes the definitions, criteria, and characteristics of these two categories of creditors, as well as the differences and similarities between them. The paper also examines the issues and challenges faced by the creditors in the insolvency resolution process, such as the initiation of the corporate insolvency resolution process (CIRP), the appointment of the interim resolution professional (IRP), the information of the committee of creditors (CoC), the voting rights and representation of the creditors, and the approval of the	The author does not analyze the reasoning behind the differential treatment of Operational Creditors. The author has not examined the position of Operational Creditor before IBC.	The researcher will analyze the reasoning behind the differential treatment of Operational Creditors. The researcher will examine the position of Operational Creditor before IBC

			<p>iresolution iplan</p> <p>The paper highlights the role and importance of the adjudicating authority, the appellate authority, and the judiciary in clarifying and resolving the ambiguities and disputes arising from the interpretation and application of the IBC.</p> <p>The paper concludes by suggesting some recommendations and suggestions for improving the effectiveness and efficiency of the IBC.</p>	
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02	Research Paper	Operational Creditors In Insolvency: A Tale Of Disenfranchisement" by Sudip Mahapatra, Misha Chandna and Pooja Singhania	The author explores the plight of operational creditors under the IBC. It argues that operational creditors are unfairly discriminated against and disenfranchised in the insolvency resolution process, as they have limited rights and remedies compared to financial creditors. The paper examines the various factors that have contributed to this situation, such as the definition and classification of operational creditors, the initiation and	The author does not examine various reports which was enacted. The author does not compare the Indian Scenario with other various Countries.	The researcher does not examine the reports on which IBC was enacted. The researcher will compare the Indian Scenario with various Countries.
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			<p>admission of insolvency applications, the formation and functioning of the CoC, the approval and implementation of the resolution plan, and the role and decisions of the adjudicating authority and the appellate authority. The paper also discusses the impact and implications of this situation on the operational creditors, the debtors, the insolvency professionals, and the economy.</p> <p>The paper concludes by suggesting some reforms and recommendations to improve the position and protection of operational creditors under the IBC. The paper is based on a comprehensive and critical analysis of the relevant provisions, rules, regulations, and judicial pronouncements under the IBC.</p>		
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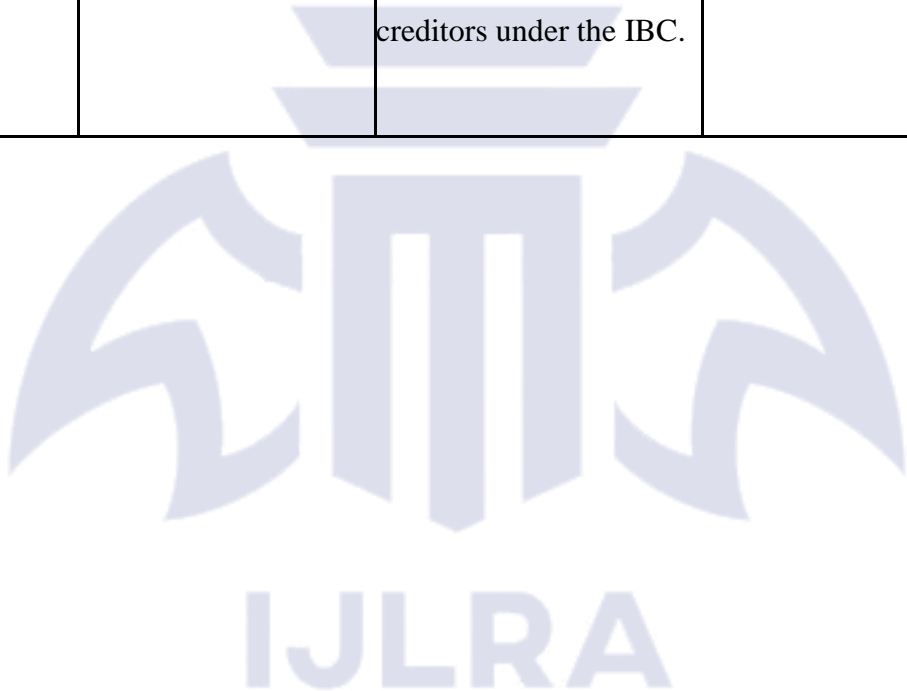
03	Research Paper	Dissenting Financial Creditors and Equitable Principle	The author examines the issue of	The author does not	The researcherw examine the
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		<p>under IBC" by Vandana Bansal</p>	<p>discrimination and disenfranchisement of dissenting financial creditors under the IBC. It argues that the IBC does not provide a fair and equitable treatment to all the creditors, especially those who do not agree with the resolution plan approved by the majority of the CoC. The paper analyses the various provisions, rules, regulations, and judicial pronouncements that have an impact on the rights and remedies of the dissenting financial creditors, such as the definition and classification of creditors, the initiation and admission of insolvency applications, the formation and functioning of the CoC, the approval and implementation of the resolution plan, and the role and decisions of the adjudicating authority and the appellate authority.</p> <p>The paper also discusses the implications and</p>	<p>examine the case laws and reasoning given by Tribunals & Supreme Court. The author does not examine the role of Operational Creditor in CIRP.</p>	<p>the case laws and reasons given by Tribunal & Supreme Court. The researcher examine the role of Operational Creditor in CIRP.</p>
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			consequences of this situation on the insolvency resolution process, the corporate debtor, the insolvency professionals, and the economy. The paper concludes by suggesting some reforms and recommendations to improve the position and protection of the dissenting financial creditors under the IBC.		
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04	Research Paper	<p>Distinction in Treatment of Financial Creditors vs. Operational Creditors by Vidushi Puri</p>	<p>The author explores the difference and discrimination between financial creditors and operational creditors under the IBC. It argues that the IBC does not provide a fair and equitable treatment to all the creditors, especially the operational creditors who have limited rights and remedies compared to the financial creditors. The paper examines the various factors that have contributed to this situation, such as the definition and classification of creditors, the initiation and admission of</p>	<p>The author fails to examine the implication & consequences which are happening due to non-availability of operational creditor under IBC. The author did not examine the recent rulings of tribunals which have highlighted the importance of operational creditor under IBC regime.</p>	<p>The researcher will examine the implications & consequences which are happening due to non-availability of operational creditor under IBC. The researcher will examine the recent rulings of tribunals which highlighted the importance of operational creditor under IBC regime.</p>
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			<p>insolvency applications, the formation and functioning of the committee of creditors (CoC), the approval and implementation of the resolution plan, and the role and decisions of the adjudicating authority and the appellate authority. The paper also discusses the implications and consequences of this situation on the insolvency resolution process, the corporate debtor, the insolvency professionals, and the economy. The paper concludes by suggesting some reforms and recommendations to improve the position and protection of the operational creditors under the IBC.</p>	
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05	Research Paper	Differential Treatment Among Creditors Under India's Insolvency and Bankruptcy Code by C. Scott Pryor & Dr. Risham Garg	The paper investigates the problems and solutions related to the unequal treatment of creditors under the IBC in India. The paper is based on empirical research that involved purposive sampling and interviews with	The author has not analysed the interplay of IBC with other laws. The author has not examined the remedies	The researcher analyse the interplay of IBC with other laws. The researcher will examine the remedies available to operational creditor and other
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			<p>various stakeholders available to laws. involved in the operational creditor in insolvency resolution other laws. process. The paper identifies the dominance of the financial creditors in the CoC, which leads to a perception of unfair and biased distributions among the classes of creditors. The inconsistency of the IBC with the public policy and the legal principles that protect the vested charges of the secured creditors. The lack of procedural fairness and transparency in the approval and implementation of the resolution plan.</p> <p>The paper suggests some reforms and recommendations to address these issues and improve the position and protection of the creditors under the IBC such as Revising the Insolvency Resolution Regulations to define "net liquidation value" as the value of the assets of the corporate debtor less the value of those assets subject to secured claims of</p>	
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			<p>holders of registered charges. Requiring any resolution plan to account for the value of the secured claims of holders of registered charges in assets of the corporate debtor.</p> <p>Requiring any resolution plan to disclose information substantiating the allocation of value within the class of financial creditors and between the classes of financial and operational creditors.</p> <p>Requiring the CoC to provide reasons for any deviation from the norm of equitable distribution of any residual enterprise value between the classes of financial and operational creditors.</p>		
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06	Research Paper	Position of operational creditors under IBC" by Anumeha Agrawal	The author critically examines the position and rights of operational creditors under the Insolvency and Bankruptcy Code, 2016 (IBC). It argues that the IBC discriminates against operational creditors in favour of financial creditors, and violatesthe principles of	The author has not provided in- depth effect which is caused by difference in position of creditors in the CIRP. The author has not examined the	The researcher provide in- depth which is caused difference in position creditors in the CIRP. The researcherw examine the position of unsecured creditor under
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			<p>equality and natural justice. The paper analyses the various provisions, rules, regulations, and judicial pronouncements that affect the status and role of operational creditors in the insolvency resolution process, such as the definition and classification of creditors, the initiation and admission of insolvency applications, the formation and functioning of the committee of creditors (CoC), the approval and implementation of the resolution plan, and the role and decisions of the adjudicating authority and the appellate authority.</p> <p>The paper also discusses the implications and consequences of this situation on the operational creditors, the corporate debtor, the insolvency professionals, and the economy. The paper concludes by suggesting some</p>	position of unsecured creditor under IBC.
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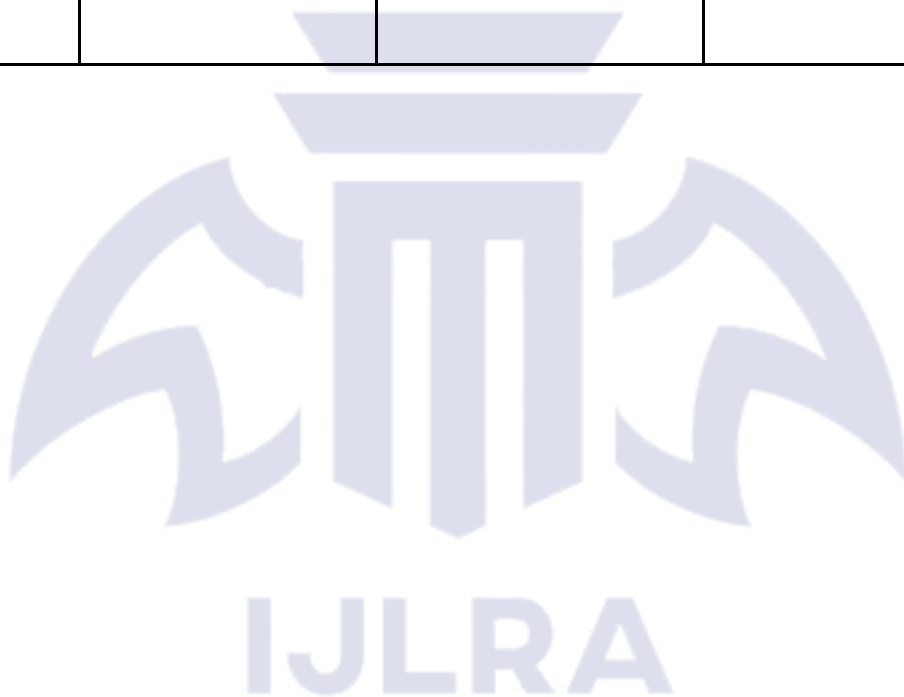
			reforms and recommendations to improve the position and protection of operational creditors under the IBC.		
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07	Research Paper	<p>Position of operational creditors: in regard to CIRP and liquidation by Avinash Kumar</p>	<p>The author critically examines the position and rights of operational creditors under the Insolvency and Bankruptcy Code, 2016 (IBC). It argues that the IBC discriminates against operational creditors in favour of financial creditors, and violates the principles of equality and natural justice. The paper analyses the various provisions, rules, regulations, and judicial pronouncements that affect the status and role of operational creditors in the insolvency resolution process, such as the definition and classification of creditors, the initiation and admission of insolvency applications, the formation and functioning of the committee of creditors</p>	<p>The author has not examined the IBC provisions vis- a- vis Company provisions in terms of recovery and liquidation. The author has not examined the position of Corporate debtor and operational creditor</p>	<p>The researcher examine the provisions vis- a- vis Company provisions terms of recovery and liquidation. The researcher examine the position of Corporate debtor operational creditor.</p>
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			<p>(CoC), the approval and implementation of the resolution plan, and the role and decisions of the adjudicating authority and the appellate authority.</p> <p>The paper also discusses the implications and consequences of this situation on the operational creditors, the corporate debtor, the insolvency professionals, and the economy. The paper concludes by suggesting some reforms and recommendations to improve the position and protection of operational creditors under the IBC.</p>		
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08	Case Law	Swiss Ribbons Pvt. Ltd. v. Union of India, 2019	The case of Swiss Ribbons Pvt. Ltd. v. Union of India is a landmark judgment by the Supreme Court of India on the constitutional validity of the Insolvency and Bankruptcy Code, 2016 (IBC). The main issue was whether the IBC violates the principles of equality, fairness, and due	The Supreme Court did not adequately address the issue of whether the classification of creditors as financial creditors and operational creditors under the IBC is reasonable	The author will examine and address the issue of whether the classification of financial creditors and operational creditors under the IBC is reasonable and non-arbitrary.
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			<p>process under Article 14 and non-arbitrary. The Supreme Court, in its judgment dated January 25, 2019, upheld the constitutionality of the IBC and rejected the challenges raised by various petitioners, including operational creditors, applicants, and corporate debtors.</p> <p>The Supreme Court addressed several aspects of the IBC, such as the role and powers of the Committee of Creditors (CoC), the resolution professional, the adjudicating authority, and the appellate authority, the eligibility criteria for resolution applicants under Section 29A, the distribution of the resolution amount among the financial and operational creditors, the time limit for completing the insolvency process, and the establishment of circuit benches for the National Company Law Appellate Tribunal (NCLAT).</p>	<p>and non-arbitrary. The Supreme Court accepted the rationale given by the legislature that the financial creditors have a direct stake in the viability of the corporate debtor and that they are better equipped to assess the feasibility of the resolution plan.</p>	<p>The author will explain the rationale and explore there are alternatives available classification.</p>
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			<p>The Supreme Court also clarified the objectives and rationale of the IBC, which are to ensure the revival of the corporate debtor, maximization of the value of its assets, promotion of entrepreneurship, availability of credit, and balancing of the interests of all the stakeholders.</p> <p>The judgment in Swiss Ribbons has laid the foundation for the implementation of the IBC and resolved several contentious issues that arose in the course of its application. It has also affirmed the supremacy of the CoC in deciding the fate of the corporate debtor and the resolution plan, subject to the judicial review by the NCLT and the NCLAT. The judgment has been widely hailed as a significant boost for the IBC regime and the ease of doing business in India.</p>		
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09	Case Law	Essar Steel India Ltd. V. Satish Kumar Gupta, 2019	The case of Essar Steel India Ltd. V. Satish Kumar Gupta is a landmark judgment by	The Supreme Court did not consider the	The author will examine the aspect
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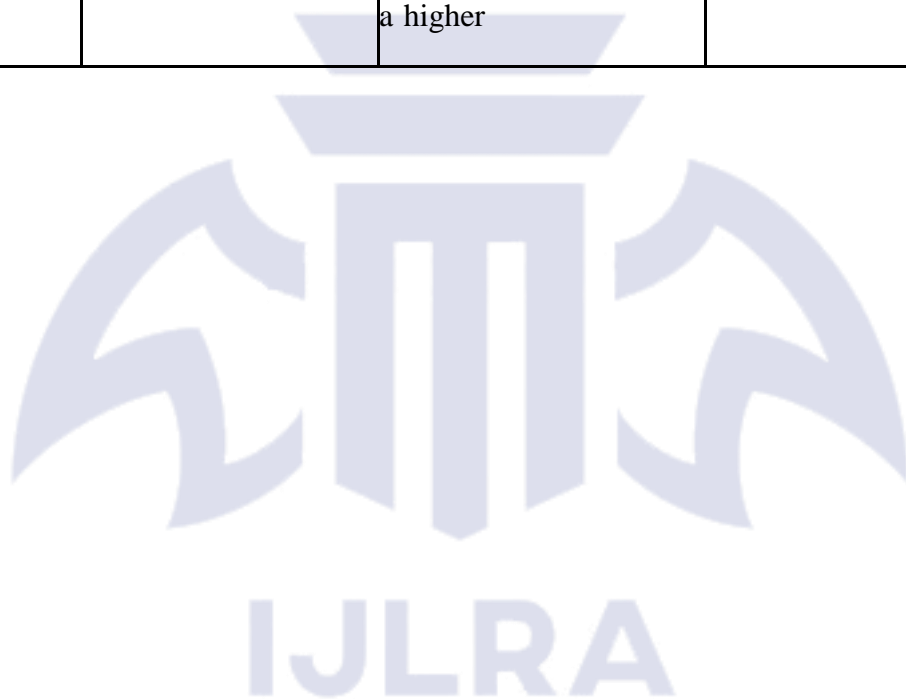


			<p>the Supreme Court of India on the insolvency and bankruptcy law in India. The main issue was whether the Committee of Creditors (CoC) of a company undergoing insolvency proceedings can distribute the resolution amount among the financial and operational creditors in a manner that is different from the statutory waterfall under Section 53 of the Insolvency and Bankruptcy Code, 2016 (IBC). The Supreme Court, in its judgment dated November 15, 2019, upheld the resolution plan submitted by ArcelorMittal India Private Limited, which had offered to pay Rs. 42,000 crore to the financial creditors and Rs. 1,200 crore to the operational creditors of Essar Steel India Ltd. The Supreme Court held that the CoC has the discretion to decide the distribution of the resolution amount, subject to the principles of fairness and equity, and that the statutory</p>	<p>fact that the operational creditors are essential for the survival and continuation of the corporate debtor and that they provide goods and services on credit without any security or guarantee. The Supreme Court also did not address the issue of whether operational creditors have a right to be represented in the CoC and to participate in decision-making process.</p>	<p>operational creditor continuity in its analysis. The author will examine the provisions and rationale of rights of operational creditor.</p>
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			<p>waterfall under Section 53 of the IBC is applicable only in the case of liquidation. The Supreme Court also clarified the role and powers of the resolution professional, the adjudicating authority, and the appellate authority under the IBC, and laid down guidelines for the timely completion of the insolvency process. The Supreme Court's judgment is considered as a significant boost for the IBC regime, as it resolved several contentious issues and paved the way for the successful resolution of one of the largest and oldest cases under the IBC.</p>	
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10.	Case Law	Rajputana Properties Pvt. Ltd. v Ultratech Cement Ltd. & Ors, 2018	The case of Rajputana Properties Pvt. Ltd. v Ultratech Cement Ltd. & Ors is a legal dispute over the acquisition of Binani Cement Ltd., a company undergoing insolvency proceedings under the Insolvency and Bankruptcy Code, 2016 (IBC). The main issue is whether Ultratech Cement Ltd., which made a higher	The NCLAT did not adequately address the issue of whether Ultratech Cement Ltd. was a related party of Binani Industries Ltd., promoter	The author will examine the ruling of tribunals of interplay with ruling SC. The author will examine the ruling principle of equity, justice and fairness.
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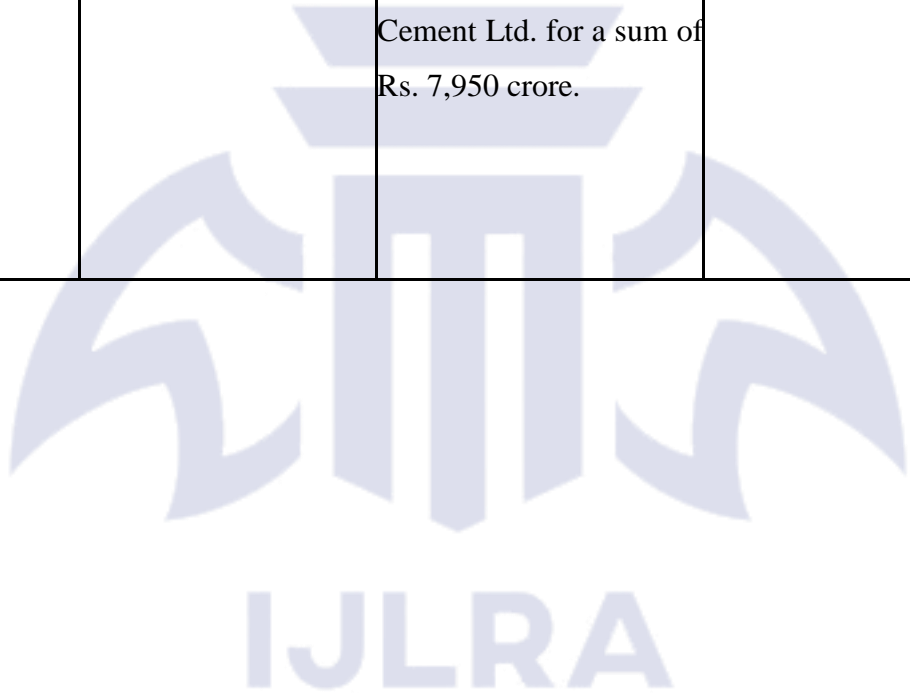
			<p>bid than Rajputana Binani Cement Ltd., Properties Pvt. Ltd. after and whether it had the deadline for violated submission of the provisions of resolution plans, can be Section considered as a valid 29A (c) and resolution applicant under (d) of the IBC, which bars the IBC. The case has persons who have an been heard by various account classified as forums, NPA or who have including the National executed a guarantee in Company Law favour of a Tribunal (NCLT), the creditor of the corporate National Company debtor from Law Appellate submitting resolution Tribunal (NCLAT), and plans.</p> <p>the Supreme Court of India. The NCLAT did not give due regard to the principle of equality and fairness among the creditors of the same class. The NCLAT approved the resolution plan of Ultratech Cement Ltd., which discriminated</p> <p>The Supreme Court, in its order dated July 2, 2018, transferred the pending proceedings before the NCLT, Kolkata to the NCLAT, and directed the NCLAT to decide all the points raised by both sides, including the eligibility of Ultratech Cement Ltd. under Section 29A of the IBC, which deals with the disqualification of certain persons from submitting resolution plans. The Supreme Court also stated that the NCLAT should not be influenced by its</p>	
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			<p>earlier order dated May 15, 2018, which had allowed the Committee of Creditors (CoC) of Binani Cement Ltd. to consider the revised offer of Ultratech Cement Ltd.</p> <p>The NCLAT, in its judgment dated November 14, 2018, upheld the revised resolution plan submitted by Ultratech Cement Ltd., and rejected the objections raised by Rajputana Properties Pvt. Ltd. The NCLAT held that Ultratech Cement Ltd. was not ineligible under Section 29A of the IBC, and that the CoC had the power to consider the revised offer in the interest of maximization of value of the assets of the corporate debtor. The NCLAT also observed that Rajputana Properties Pvt. Ltd. had failed to match the offer of Ultratech Cement Ltd., and that its resolution plan did not adequately protect the interests of the operational creditors of Binani Cement Ltd.</p>	<p>between the financial creditors of Binani Cement Ltd. on the basis of their security interest. The NCLAT also ignored the fact that the resolution plan of Rajputana Properties Pvt. Ltd. offered a higher recovery to the operational creditors of Binani Cement Ltd. than the resolution plan of Ultratech Cement Ltd.</p>
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			<p>Rajputana Properties Pvt. Ltd. challenged the NCLAT judgment before the Supreme Court, but the Supreme Court dismissed the appeal on November 19, 2018, and confirmed the approval of Ultratech Cement Ltd.'s resolution plan. Thus, the case was finally resolved in favour of Ultratech Cement Ltd., which acquired Binani Cement Ltd. for a sum of Rs. 7,950 crore.</p>	
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CHAPTER 2

NEED & EVOLUTION OF IBC

2.1 Introduction

Before the introduction of the Insolvency and Bankruptcy Code (IBC) in 2016, India's insolvency and bankruptcy framework faced significant challenges and inefficiencies. The need for a comprehensive legal framework to address insolvency and bankruptcy issues arose due to several factors, including outdated laws, lengthy legal procedures, inadequate creditor protection, and a lack of a formal mechanism for corporate restructuring and resolution. Historically, India's insolvency and bankruptcy regime was governed by multiple fragmented laws and regulations, leading to inconsistency, delays,¹ and inefficiencies in the resolution process. Some of the key legislations that were in place prior to the IBC include:

1. Presidency Towns Insolvency Act, 1909: This legislation applied to the three presidency towns of Calcutta, Bombay, and Madras, and it primarily dealt with insolvency proceedings for individuals and partnerships in these areas.
2. Provincial Insolvency Act, 1920: This Act applied to the rest of India and provided a framework for insolvency proceedings for individuals and partnerships outside the presidency towns.
3. Sick Industrial Companies (Special Provisions) Act, 1985 (SICA): SICA was introduced to address the issue of industrial sickness and aimed to rehabilitate financially distressed companies. However, it suffered from various shortcomings, including delays in decision-making, lack of creditor involvement, and ineffective restructuring mechanisms.
4. Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002: SARFAESI was primarily focused on empowering banks and financial institutions to recover non-performing assets (NPAs) by enforcing security interests without court intervention. While it facilitated faster recovery of dues, it lacked a comprehensive mechanism for corporate insolvency resolution. Despite these existing laws, the insolvency and bankruptcy landscape in India was marked by prolonged litigation, inadequate creditor rights, and limited avenues for debt recovery and restructuring.² There was

¹ Dhanjay Kumar, 'The New Corporate Insolvency Regime in India: A Paradigm Shift' (April 2019) Amer. Bankr. Inst. J. 38

² Adam Feibelman, 'Legal Shock or False Start? The Uncertain Future of India's New Personal Insolvency and Bankruptcy Regime' Tulane Public Law Research Paper, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3092042 (last accessed on 16-02-2024)

a pressing need for a modern and unified legal framework to address these challenges and promote a more efficient and transparent insolvency resolution process.

Recognizing these shortcomings, the Indian government embarked on a journey to reform the insolvency and bankruptcy framework by introducing the Insolvency and Bankruptcy Code, 2016. The IBC aimed to streamline the insolvency resolution process, enhance creditor rights³, facilitate timely resolution of distressed assets, and promote a culture of entrepreneurship and risk-taking in the Indian economy.⁴ Overall, the background and history preceding the introduction of the IBC underscored the imperative for a comprehensive and modern insolvency framework to address the evolving needs of India's dynamic economy and promote sustainable growth and development.

2.2 Shortcomings of Legislations

Let's delve deeper into the shortcomings of each of the legislations that were in place before the introduction of the IBC in India:

1. **Presidency Towns Insolvency Act, 1909:** The Act applied only to the presidency towns of Calcutta, Bombay, and Madras, leaving out other regions of the country. It primarily dealt with insolvency proceedings for individuals and partnerships, lacking provisions for corporate insolvency. Over time, the Act became outdated and was unable to address the complexities of modern corporate insolvency and bankruptcy.
2. **Provincial Insolvency Act, 1920:** Similar to the Presidency Towns Insolvency Act, this Act provided a framework for insolvency proceedings outside the presidency towns, resulting in fragmentation and inconsistency in the legal regime. It focused mainly on insolvency proceedings for individuals and partnerships, failing to address the needs of corporate entities.⁵ The legal procedures under the Act were often lengthy and cumbersome, leading to delays in resolving insolvency cases.
3. **Sick Industrial Companies (Special Provisions) Act, 1985 (SICA):** SICA suffered from significant delays in decision-making due to bureaucratic processes and ineffective mechanisms for identifying and addressing industrial sickness. The Act did not adequately involve creditors in the restructuring process, leading to skewed incentives and inefficiencies in the resolution of distressed companies. Despite its objectives to rehabilitate financially distressed companies, SICA often failed to

³ Shikha Rawal, 'The Evolutionary Landscape of the Insolvency and Bankruptcy Code in India-Analysis and Key Observations' (November 2017) <https://papers.ssrn.com/sol3/papers.cfm?abstract-id=3079292> (last accessed on 16-02-2024).

⁴ Nimrit Kang & Nitin Nayar, 'The Evolution of Corporate Bankruptcy Law in India' ICRA Bulletin: Money and Finance, 37 (2003).

⁵ Insolvency and Bankruptcy Code, No. 31 of 2016, s 25(2)(j), India Code (2016) (authorizing the resolution professional to pursue avoidance actions described in Chapter 3).

achieve meaningful restructuring outcomes, leading to the liquidation of viable assets and loss of value for stakeholders.⁶

4. Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002: SARFAESI primarily focused on the enforcement of security interests by banks and financial institutions, overlooking the broader aspects of insolvency resolution and corporate restructuring. While SARFAESI empowered lenders to recover non-performing assets (NPAs) without court intervention, it did not provide adequate protection for other creditors or promote a fair and transparent resolution process. The Act lacked comprehensive mechanisms for debt restructuring and corporate rehabilitation, resulting in suboptimal outcomes for distressed companies and their stakeholders.

The shortcomings of the pre-IBC legislations in India included limited applicability, fragmented frameworks, delayed decision-making, inadequate creditor protection, and ineffective mechanisms for corporate restructuring and resolution.⁷ These deficiencies underscored the need for a comprehensive and modern insolvency and bankruptcy framework, leading to the introduction of the Insolvency and Bankruptcy Code in 2016.

Introduction of the Insolvency and Bankruptcy Code (IBC) in India marked a significant milestone in the country's legal and economic landscape. Enacted in 2016, the IBC aimed to overhaul the existing insolvency and bankruptcy framework, addressing long-standing inefficiencies, promoting creditor rights, and facilitating timely resolution of distressed assets. This comprehensive legislation was introduced to streamline the insolvency resolution process, enhance investor confidence, and foster a conducive environment for economic growth and development. In this detailed exploration, we'll delve into the reasons behind the introduction of the IBC, its key features, the impact it has had on India's economy and legal system, and the inspiration drawn from other jurisdictions.

The introduction of the Insolvency and Bankruptcy Code in India was necessitated by various shortcomings in the previous insolvency and bankruptcy framework. Some of the key reasons behind its introduction include:

- a. Fragmented Legal Framework: Prior to the IBC, India's insolvency and bankruptcy regime was governed by multiple outdated laws, including the Presidency Towns Insolvency Act, 1909, the Provincial Insolvency Act, 1920, and the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA). This fragmented legal framework led to inconsistency, delays, and inefficiencies in the resolution process, hampering the recovery of distressed assets and discouraging creditor participation.

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⁶ Insolvency and Bankruptcy Board of India (IBBI), Insolvency Resolution Process for Corporate Persons, Regulations, 2016 (CIRP Regulation).

⁷ Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 5(8), 7, India Code (2016), available at <http://indiacode.nic.in>. (last accessed on 16-02-2024).

⁸ The Bankruptcy Law Reforms Committee Report.

- b. **Ineffective Resolution Mechanisms:** The existing laws lacked effective mechanisms for corporate restructuring and resolution, resulting in prolonged litigation, value erosion, and suboptimal outcomes for stakeholders. There was a pressing need for a modern and unified insolvency framework to expedite the resolution process, preserve asset value, and maximize creditor recovery.
- c. **Limited Creditor Rights:** The insolvency regime in India suffered from inadequate creditor protection, with creditors often facing lengthy delays and uncertainty in recovering their dues. Strengthening⁹ creditor rights and establishing a transparent and predictable insolvency framework were crucial for promoting investor confidence and attracting investment in the Indian economy.
- d. **Promoting Ease of Doing Business:** Addressing deficiencies in the insolvency and bankruptcy framework was essential for improving India's ranking in global indices such as the Ease of Doing Business report. A robust and efficient insolvency regime was imperative for enhancing the ease of doing business, fostering entrepreneurship, and supporting sustainable economic growth.

The Insolvency and Bankruptcy Code introduced several key features aimed at revolutionizing the insolvency resolution process in India:

- a. **Unified Legal Framework:** The IBC provided a single, comprehensive legal framework for the resolution of insolvency and bankruptcy across all sectors, replacing the fragmented laws that were previously in place. This streamlined approach eliminated inconsistencies and provided clarity and certainty to stakeholders.¹⁰
- b. **Time-bound Resolution Process:** One of the hallmark features of the IBC was the introduction of strict timelines for the resolution of insolvency cases. The Code mandated a time-bound process, with a maximum period of 330 days, including litigation time, for the resolution of corporate insolvency cases, ensuring swift and efficient resolution.
- c. **Insolvency Resolution Professionals (IRPs):** The IBC introduced the concept of Insolvency Resolution Professionals (IRPs), who are licensed professionals responsible for managing the insolvency resolution process. IRPs play a pivotal role in facilitating negotiations between debtors and creditors, conducting due diligence, and overseeing the resolution proceedings.

⁹ Some Emerging Trends In The Evolution of Insolvency And Bankruptcy Code

¹⁰ Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 5(20), 9, India Code (2016), available at <http://indiacode.nic.in>. (last accessed on 16-02-2024).

- d. **Committee of Creditors (CoC):** Under the IBC, a Committee of Creditors (CoC) is constituted for each insolvent entity, comprising financial creditors who have a stake in the resolution process. The CoC plays a crucial role in decision-making, including the approval of resolution plans and the initiation of liquidation proceedings if required.
- e. **Insolvency Resolution Mechanisms:** The IBC provides for multiple insolvency resolution mechanisms, including Corporate Insolvency Resolution Process (CIRP) for corporates, and individual insolvency resolution process for individuals and partnership firms. These mechanisms offer flexibility and tailored solutions for different types of debtors.¹¹
- f. **Cross-Border Insolvency:** The IBC includes provisions for addressing cross-border insolvency, enabling cooperation and coordination with foreign jurisdictions in resolving insolvency cases involving multinational companies.¹²

This ensures greater efficiency and effectiveness in dealing with complex cross-border insolvency issues.

The Insolvency and Bankruptcy Code has had a profound impact on India's economy and legal landscape since its introduction:

- a. **Improved Credit Culture:** The IBC has contributed to a significant shift in the credit culture in India, promoting responsible lending practices and enhancing creditor confidence. The strict timelines and robust resolution mechanisms have incentivized timely repayment of debts and discouraged wilful defaults.¹³
- b. **Resolution of Stressed Assets:** The introduction of the IBC has expedited the resolution of stressed assets in India, leading to the recovery of significant amounts of non-performing loans (NPLs) and reducing the burden on banks and financial institutions. The Code has facilitated the revival of viable businesses and the maximization of value for creditors.
- c. **Enhanced Investor Confidence:** The transparency, predictability, and efficiency of the insolvency resolution process under the IBC have bolstered investor confidence in India's business environment. The Code has positioned India as an attractive destination for investment, with improved risk management and dispute resolution mechanisms.
- d. **Legal and Institutional Reforms:** The implementation of the IBC has necessitated significant legal and institutional reforms, including the establishment of specialized adjudicatory bodies such as the National Company Law Tribunal

¹¹ Kumar Mittal, A., 'Analysis of the Amendments to the CIRP Regulations' (available at: <https://www.scconline.com/blog/post/2022/03/11/analysis-of-the-amendments-to-the-cirp-regulations/>) (last accessed on 16-02-2024)

¹² Insolvency and Bankruptcy Code, No. 31 of 2016, § 6, India Code (2016), available at <http://indiacode.nic.in>.

¹³ Ministry of Finance, Government of India, 'The Report of the Bankruptcy Law Reforms Committee, Volume I: Rationale and Design' (November 2015).

(NCLT) and the Insolvency and Bankruptcy Board of India (IBBI). These reforms have strengthened the institutional framework for insolvency resolution and governance in India.¹⁴

- e. Economic Growth and Development: By promoting the timely resolution of distressed assets, facilitating corporate restructuring, and fostering a conducive business environment, the IBC has contributed to sustainable economic growth and development in India. The Code has stimulated entrepreneurship, encouraged innovation, and supported the emergence of a dynamic and resilient economy.

The Insolvency and Bankruptcy Code draws inspiration from various international best practices and is largely based on the recommendations of the Bankruptcy Law Reforms Committee (BLRC) chaired by Dr. T.K. Vishwanathan.¹⁵ While the IBC is a domestic legislation tailored to India's unique economic and legal context, it incorporates principles and concepts from insolvency regimes in countries such as the United States, the United Kingdom, and Australia.

- a. United States: The Chapter 11 bankruptcy provisions of the United States Bankruptcy Code served as a model for the corporate insolvency resolution process under the IBC. The debtor-in-possession (DIP) model, creditor committees, and restructuring plans are some of the key concepts adopted from the U.S. bankruptcy framework.¹⁶
- b. United Kingdom: The United Kingdom's insolvency regime, particularly the administration process and the role of insolvency practitioners, influenced certain aspects of the IBC. The emphasis on rescue and restructuring, creditor participation, and professional standards in insolvency administration were among the key principles drawn from the UK insolvency framework.¹⁷
- c. Australia: Australia's insolvency laws, including the voluntary administration process and the role of administrators, provided insights into the design and implementation of the IBC. The focus on early intervention, debtor-in-possession financing, and creditor rights in the Australian insolvency regime informed the development of the IBC's resolution mechanisms.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Dhruvi Chheda, Shivani Kapur Jeet, Nasrin Shaikh, Vidit Mehra, Nuances Under The Insolvency And Bankruptcy Code, 2016, Mondaq (July 02, 2021), <https://www.mondaq.com/india/insolvencybankruptcy/1087164/nuances-under-the-insolvency-and-bankruptcy-code-2016?type=mondaqai&score=78> (last accessed on 16-02-2024)

¹⁷ Ernst & Young, How Does The Corporate Insolvency Code In India Measure With The UK?, Mondaq, (Dec. 08, 2016) <https://www.mondaq.com/india/insolvencybankruptcy/551286/how-does-the-corporate-insolvency-code-in-india-measure-with-the-uk> (last accessed on 16-02-2024)

The introduction of the Insolvency and Bankruptcy Code in India was a transformative step towards addressing longstanding inefficiencies in the insolvency and bankruptcy framework, promoting creditor rights, and fostering a conducive environment for economic growth and development. With its comprehensive legal framework, strict timelines, and robust resolution mechanisms, the IBC has significantly improved the ease of doing business, enhanced investor confidence, and facilitated the resolution of distressed assets in India. Drawing inspiration from international best practices, the IBC represents a paradigm shift in India's approach to insolvency resolution and governance, positioning the country as a global leader in the field of corporate restructuring and bankruptcy law.¹⁸

CHAPTER 3

TYPES OF CREDITOR UNDER IBC & DIFFERENTIAL TREATMENT

Certainly! Let's explore the types of creditors under the Insolvency and Bankruptcy Code (IBC), the process of Corporate Insolvency Resolution Process (CIRP), and the different treatment of creditors under the IBC:

1. **The Process of CIRP:** The Corporate Insolvency Resolution Process (CIRP) is a key mechanism under the Insolvency and Bankruptcy Code (IBC) for resolving insolvency cases involving corporate debtors. The process involves several stages, including initiation, appointment of resolution professionals, formulation and approval of resolution plans, and finally, implementation or liquidation if a resolution plan is not feasible. The CIRP begins with the initiation of insolvency proceedings against a corporate debtor by a financial creditor, operational creditor, or the corporate debtor itself. The application for initiation of insolvency proceedings is submitted to the National Company Law Tribunal (NCLT), which evaluates the application and admits it if the prescribed criteria are met. Upon admission of the insolvency application, a moratorium period is declared, during which no legal action can be taken against the corporate debtor, and the management of the company is temporarily taken over by the resolution professional.¹⁹ The NCLT appoints an Insolvency Professional (IP) as the resolution professional (RP) to manage the affairs of the corporate debtor during the CIRP. The RP assumes control of the company, conducts due diligence, invites claims from creditors, and oversees the resolution process. The RP prepares an Information Memorandum (IM) containing relevant information about the corporate debtor, its assets, liabilities, and financial position. The IM is circulated to prospective resolution applicants to facilitate the submission of resolution plans.

¹⁸ Nikhil Khatri, Debtor-in-possession vs creditor-in-possession insolvency models, Mondaq, (Dec. 04, 2020) <https://www.mondaq.com/australia/insolvencybankruptcy/1013138/debtor-in-possession-vs-creditor-in-possession-insolvency-models> (last accessed on 16-02-2024)

¹⁹ Karbhari, F., & Shikha, A., 'India: Commercial Wisdom Of Committee Of Creditors', Mondaq (available at: <https://www.mondaq.com/india/insolvencybankruptcy/1080856/commercial-wisdom-of-committee-of-creditors-> .

Prospective resolution applicants submit resolution plans outlining their proposals for the revival or restructuring of the corporate debtor. The Committee of Creditors (CoC) evaluates the resolution plans based on viability, feasibility, and maximization of creditor recovery. Once a resolution plan is approved by the CoC with the requisite majority, it is submitted to the NCLT for final approval.

If the NCLT approves the resolution plan, it is implemented, and the corporate debtor continues its operations under the new ownership or management structure as per the terms of the plan. However, if no viable resolution plan is approved within the prescribed timeline or the approved plan fails to be implemented, the corporate debtor is liquidated, and its assets are sold to repay creditors. Under the Insolvency and Bankruptcy Code,²⁰ creditors are categorized into two main types based on their relationship with the corporate debtor and the nature of their claims:

- a. **Financial Creditors:** Financial creditors are entities that extend financial facilities to the corporate debtor, including banks, financial institutions, and debentureholders. They have a primary claim on the assets of the corporate debtor and are entitled to participate in the insolvency resolution process as members of the Committee of Creditors (CoC). Financial creditors typically hold secured or unsecured debt and play a crucial role in determining the outcome of the resolution process.
- b. **Operational Creditors:** Operational creditors are individuals or entities that provide goods or services to the corporate debtor in the ordinary course of business, such as suppliers, vendors, employees, and service providers. They have operational claims against the corporate debtor for unpaid dues, such as outstanding invoices, salaries, or rent.²¹ While operational creditors do not have a direct say in the insolvency resolution process, they are entitled to participate in the CIRP and submit their claims to the resolution professional for verification.

3.1 Differential treatment of Creditors under IBC

Under the Insolvency and Bankruptcy Code (IBC) in India, creditors encounter varying treatment throughout the insolvency resolution process. This differential treatment arises from factors such as voting rights, priority in asset distribution, treatment under resolution plans, and the protection of their rights. The voting rights of creditors delineate their participation in crucial decisions during the insolvency resolution process. The IBC establishes a structured mechanism for decision-making, primarily through the Committee

²⁰ Insolvency and Bankruptcy Code, No. 31 of 2016, s 23, INDIA CODE (2016) <http://indiacode.nic.in>. ²¹ The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Third Amendment) Regulations, 2018, Gazette of India, pt. III sec. 4 (July 4, 2018), § 36A, at 30, available at [http://egazette.nic.in/\(S\(qxwohkrzgcchoanufmumlgj\)\)/Search1.aspx](http://egazette.nic.in/(S(qxwohkrzgcchoanufmumlgj))/Search1.aspx). (last accessed on 16-02-2024)

of Creditors (CoC). Financial creditors, including banks, financial institutions, and debenture holders, possess significant voting rights in the CoC. Their influence stems from their representation and stake in the financial affairs of the corporate debtor.²² Operational creditors, on the other hand, lack direct voting rights in the CoC. Despite their integral role in the business operations of the corporate debtor, operational creditors do not wield the same level of influence as financial creditors. This asymmetry in voting rights reflects the distinct interests and priorities of different classes of creditors within the insolvency resolution framework. The CoC plays a pivotal role in determining the fate of the corporate debtor by evaluating resolution plans, approving restructuring proposals, and making critical decisions regarding the future course of action. Financial creditors' voting rights empower them to shape the outcome of the resolution process, ensuring alignment with their interests and objectives.²³ The priority in the distribution of assets is a fundamental aspect of creditor treatment under the IBC, particularly in the context of liquidation proceedings. The Code establishes a hierarchical framework that governs the distribution of proceeds from the sale of assets among creditors. Secured financial creditors, whose debts are backed by collateral, enjoy precedence over other creditors in asset distribution. Their claims are satisfied first from the proceeds of the sale of secured assets, ensuring the protection of their interests and the realization of their dues. Unsecured financial creditors, including debenture holders and other lenders with unsecured debt, follow secured creditors in the distribution hierarchy. Their claims are addressed after the satisfaction of secured creditors' dues, albeit with lower priority.

Operational creditors occupy a subordinate position in the asset distribution hierarchy, following the satisfaction of financial creditors' claims. Despite their vital contributions to the operations of the corporate debtor, operational creditors typically have lower priority in asset recovery during liquidation.²⁴ This differential treatment of creditors in asset distribution reflects the principle of equitable distribution and seeks to balance the competing interests of various stakeholders involved in the insolvency resolution process.

The treatment of creditors under resolution plans encompasses the restructuring or settlement of their claims in accordance with the proposed revival or rehabilitation strategy for the corporate debtor. Resolution plans play a crucial role in determining the fate of creditors and the ultimate outcome of the insolvency resolution process.²⁵ Financial

²² Singh, G., Need for Judicial Scrutiny of the Commercial Wisdom of COC, The Indian Review of Corporate and Commercial Laws (IRCCCL) (available at: <https://www.ircccl.in/post/need-for-judicial-scrutiny-of-the-commercial-wisdom-ofcoc>). (last accessed on 16-02-2024)

²³ Insolvency and Bankruptcy Board of India, Insolvency and Bankruptcy Regime in India: A Narrative, (available at: <https://www.ibbi.gov.in/uploads/whatsnew/2020-10-01-210733-43cms-9224c9b668aac0d6149a5d866bfb4c79.pdf>). (last accessed on 16-02-2024)

²⁴ Ministry of Corporate Affairs, 32nd Standing Committee on Finance Report, 'Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions' (available at: <https://www.ibbi.gov.in/uploads/whatsnew/fc8fd95f0816acc5b6ab9e64c0a892ac.pdf>). (last accessed on 16-02-2024)

²⁵ Ibid.

creditors may have their claims restructured, converted into equity or debt instruments, or settled through cash payments as part of the approved resolution plan. The objective is to maximize creditor recovery while ensuring the viability and sustainability of the corporate debtor's operations. Operational creditors, although not directly involved in the formulation of resolution plans, may receive partial or full payment of their outstanding dues over time or through negotiated settlements. The treatment of operational creditors under resolution plans reflects the need to balance their interests with the broader objectives of the resolution process.

The approval and implementation of resolution plans require careful consideration of creditors' interests, feasibility assessments, and adherence to statutory requirements. The CoC plays a pivotal role in evaluating and approving resolution plans, ensuring alignment with creditor priorities and the overarching objectives of the IBC. The protection of creditors' rights is a cornerstone of the insolvency resolution framework under the IBC. The Code includes provisions aimed at safeguarding creditors' interests, promoting transparency, and facilitating the resolution of insolvency cases in a fair and orderly manner. Both financial and operational creditors have the right to file claims, participate in insolvency proceedings, and seek redressal for grievances through appropriate legal channels.²⁶ These rights ensure that creditors are adequately represented and have a voice in decisions that affect their interests.

The role of resolution professionals and the adjudicatory authorities, such as the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT), is critical in upholding creditors' rights and ensuring compliance with the provisions of the IBC. The IBC establishes a robust framework for the protection of creditors' rights, encompassing mechanisms for dispute resolution, enforcement of claims, and recourse against unfair practices or misconduct.²⁷ These safeguards instill confidence among creditors and promote the efficient functioning of the insolvency resolution process.

The treatment of creditors under the IBC is characterized by a nuanced interplay of voting rights, priority in asset distribution, treatment under resolution plans, and the protection of their rights. These aspects reflect the complexities inherent in insolvency resolution and the need to balance the interests of various stakeholders involved.²⁸ A clear understanding of creditor treatment under the IBC is essential for navigating the insolvency landscape and maximizing creditor recovery in a fair and equitable manner.

²⁶ Ibid.

²⁷ Insolvency and Bankruptcy Board of India, 'Discussion Paper', IBBI (available at: <https://ibbi.gov.in/Discussionpaper-CIRP-27Aug2021.pdf>); Insolvency and Bankruptcy Code, 2016, No.31, Acts of Parliament, 2016 (India), Section 22.

²⁸ Singh, G., Need for Judicial Scrutiny of the Commercial Wisdom of COC, The Indian Review of Corporate and Commercial Laws (IRCCCL) (available at: <https://www.ircl.in/post/need-for-judicial-scrutiny-of-the-commercial-wisdom-ofcoc>).

CHAPTER 4

ISSUES RELATED TO DIFFERENTIAL TREATMENT

Issues pertaining to the legal framework governing secured credit in India necessitate an initial examination from a global standpoint concerning secured credit in general. Only after this broader perspective will the correlation between secured credit and the legal framework for insolvency be explored.²⁹

4.1 Major Issues Related to Differential Treatment

4.1.1 International Standards for Secured Credit

The World Bank's "Principles for Effective Insolvency and Creditor/Debtor Rights" (referred to as "World Bank Principles") commence with the acknowledgment that a cornerstone of a contemporary credit-based economy involves the ability to provide security interests to creditors, enabling access to credit at more favorable terms. Essentially, secured lending is a fundamental component of an economic structure reliant on credit. Consequently, the availability of credit, alongside investment, is pivotal in expanding the breadth and depth of goods and services accessible.

Merely possessing the authority to grant security interests isn't adequate to stimulate credit and economic advancement. There must be a corresponding legal framework that duly recognizes, regulates, and enforces these security interests. The practice of using collateral as security for a debt has endured for generations. However, what distinguishes an effective modern system of secured credit in a credit-driven economy are the principles of abstraction and reification. Essentially, the concept of security is detached from physical possession as the initial step.

Subsequently, the abstract concept of a "security interest" is materialized into a legal construct, meaning it becomes legally enforceable. However, legal constructs in isolation are inadequate unless integrated into a functional legal framework. The synergy between a legal construct and a legal system is what the World Bank refers to as a legal framework.

The World Bank Principles stipulate that an effective legal framework for secured lending "should enable efficient notice and registration regulations to be adapted to all forms of property, and should establish clear rules of precedence regarding conflicting claims or interests in the same assets." The World Bank Principles conclude by asserting that a nation's legal system for insolvency should operate in conjunction with its framework for secured lending, ensuring that insolvency systems "should aim to: ...(x) acknowledge

²⁹ See VINOD KOTHARI, *SECURITIZATION ASSETS RECONSTRUCTION AND ENFORCEMENT OF SECURITY INTERESTS* 1057 (4th ed. LexisNexis 2013) (discussing SARFAESI § 13(9)).

existing creditor rights and uphold the hierarchy of claims through a foreseeable and established process."³⁰

4.1.2 The general legal context for secured credit in India

The overall legal landscape concerning secured credit in India lacks a comprehensive framework that adequately covers the establishment, public acknowledgment, priority, and enforcement of security interests. Currently, no single statute encompasses all these aspects. The Securitization Assets Reconstruction and Enforcement of Security Interests Act (SARFAESI) focuses solely on the enforcement of charges, but it is limited to banks or financial institutions. SARFAESI is deficient as a comprehensive legal framework for another reason: Except in cases where secured creditors have reached an agreement among themselves³¹, SARFAESI does not offer a mechanism for multiple secured creditors of different types to establish precedence in movable collateral. Naturally, according to common law principles, holders of first charges should take precedence over subsequent ones. Although SARFAESI does not directly tackle this issue, the Companies Act of 2013 addresses it by stipulating that the order of registration serves as the statutory means for demonstrating priority. Consequently, albeit indirectly, India's non-bankruptcy legislation aligns closely with international standards for secured credit.

4.1.3 The legal context for secured credit in insolvency proceedings in India

The legal framework concerning secured credit in insolvency proceedings in India is delineated by sections 5(7) and (20) of the IBC, which recognize two distinct classes of creditors: financial and operational. However, the utilization of these terms in the Corporate Insolvency Resolution Process (CIRP) rather than legal designations like secured and unsecured creditors has led to complications. While "financial" and "operational" serve as descriptive terms reflecting the nature of the creditor-debtor relationship, they lack intrinsic legal significance. The essential legal distinction lies between secured and unsecured creditors, where the former not only asserts a debt claim but also holds an interest in the debtor's property. The initial failure of the CIRP to acknowledge a creditor's secured status prompted the National Company Law Appellate Tribunal (NCLAT) to conclude that all financial creditors, whether secured or unsecured, must be treated equally.³² Subsequently, in the Essar Steel appeal, the NCLAT extended this principle, advocating for similar treatment of all financial creditors, regardless of their secured status, and even proposing near-identical treatment for financial and operational creditors. In response to these developments, India's Parliament swiftly amended the CIRP provisions following a

³⁰ Sriram, 'A Code of Conduct for Committee of Creditors', IBBI <available at:

<https://ibbi.gov.in/uploads/resources/6736e357f5c139e6402b038f4492e10b.pdf>. (last accessed on 16-02-2024)

³¹ The Supreme Court's decision in the Essar Steel case appears to grant the Committee of Creditors significant discretion in deciding whether to allocate any surplus value beyond the collateral of financial creditors to operational creditors. See Essar Steel, supra note 64 at 93.

³² Committee of Creditors of Essar Steel India Limited v. Satish Kuman Gupta (Supreme Court 2019) is accessible at <https://main.sci.gov.in/supremecourt/2019/24417/24417-2019-4-1501-18158judgement-15-Nov-2019.pdf>. (last accessed on 16-02-2024)

proposal from the Cabinet. The 2019 Amendments linked the confirmation standards of IBC section 30 to the recognition of security interests of financial creditors. The Supreme Court of India upheld the validity of these amendments three months later in an appeal from the NCLAT judgment in the Essar Steel case.

Post-2019 Amendments, IBC section 30(2)(b) mandates that operational creditors receive no less than the higher of either their entitlement under liquidation as per IBC section 53 or the amount distributed under the liquidation waterfall of section 53 if the resolution plan is implemented. Furthermore, dissenting financial creditors are limited to receiving no more than the liquidation value of their collateral, if applicable. These amendments unequivocally affirm that security interests persist during a CIRP, ensuring that charge holders are entitled to at least the liquidation value of their collateral. Consequently, the CIRP provisions are realigned with international norms. Additionally, the 2019 Amendments delegate the regulatory implementation of IBC section 30 to the Insolvency and Bankruptcy Board of India (IBBI). In the final appeal of the Essar Steel case, the Supreme Court issued a comprehensive 164-page opinion, overturning the decision of the appellate panel and providing detailed insights into the role of secured credit within the CIRP framework.³³

Working from the text of the 2019 Amendments and synthesizing a range of international materials the Court concluded that

It can be seen that the Code and the Regulations, read as a whole, together with the observations of expert bodies and this Court's judgment, all lead to the conclusion that the equality principle cannot be stretched to treating unequals equally, as that will destroy the very objective of the Code Equitable treatment

is to be accorded to each creditor depending upon the class to which it belongs: secured or unsecured, financial or operational. 70

While the 2019 Amendments address certain issues, they fail to acknowledge the claim of operational creditors to a portion of any remaining enterprise value, and in fact, they might even weaken such a claim. Explanation 1, which was introduced by the 2019 Amendments into IBC section 30, stipulates that regardless of the enterprise value, a distribution in line with the provisions of IBC section 30(2)(b) shall be deemed "fair and equitable." This concept of "fair and equitable," as utilized in the cramdown provision of the United States Bankruptcy Code, limits the priority of secured creditors to the value of their collateral rather than the amount of their claims. In contrast, gauging fairness and equity based on the liquidation waterfall of IBC section 53(1) may prevent operational creditors from raising distributional grievances but may divert additional value to financial creditors at their expense.³⁴

³³ Karan Singh Chandhok, "India: Restructuring & Insolvency Comparative Guide," Mondaq (Apr. 26, 2021), available at <https://www.mondaq.com/india/insolvencybankruptcyre-structuring/939078/restructuring-insolvency-comparative-guide>. (last accessed on 16-02-2024)

³⁴ Ibid.

For instance, consider the scenario where OldCo, a corporate debtor valued at \$10 million as a going concern but only \$5 million in liquidation, enters a CIRP. Assume that OldCo owes \$10 million to FinCred, a financial creditor with a perfected security interest in all of OldCo's assets, and an additional \$5 million to unsecured creditors. If NewCo proposes a resolution plan for \$10 million post-2019 Amendments, FinCred would be entitled to the entire \$10 million. Conversely, under Chapter 11, FinCred would have received \$5 million for its secured claim and \$2.5 million for its unsecured claim if a similar plan were to be forced on it. The remaining \$2.5 million would have been distributed among general unsecured creditors.

A resolution plan under the amended IBC section 30 would be deemed acceptable even if the total amount received by financial creditors exceeds the value of all collateral, provided that the plan compensates operational creditors with the liquidation value of unsecured property. This is because the liquidation provisions of IBC section 53(1)(d) and (e) prioritize even unsecured financial debts (and deficiencies) owed to secured creditors over operational debts, allowing all financial debts—not just the value of collateral securing those debts—to be paid to financial creditors before any remaining value is allocated to general unsecured creditors.³⁵

For example, in a scenario similar to Example 1 but with FinCred's security interest only attaching to assets worth \$8 million, a \$10 million resolution plan could be approved if it were to allocate \$9 million to FinCred and only \$1 million to general unsecured creditors.

If a plan akin to Example 2 is sanctioned, it is likely that such an interpretation of the 2019 Amendments will be contested in the Supreme Court. The adoption of the amendments to the CIRP Regulations described in Part V would mitigate this issue.

4.1.4 The practical context for secured credit in insolvency in India

Data released by the Insolvency and Bankruptcy Board of India (IBBI) indicates that many resolution plans may have considered the worth of collateral despite initial judicial ambiguity. In early 2019, the IBBI published a table titled "Corporate Insolvency Resolution Processes Yielding Resolution Plans: As on 31st December, 2018." This table, extracted in Appendix 2, demonstrates that operational creditors achieved cumulative recoveries exceeding 50% of admitted claims across numerous Corporate Insolvency Resolution Process (CIRP) proceedings. However, a closer examination of the data within the table reveals two significant issues with this optimistic portrayal.³⁶

Firstly, there appears to be little correlation between the stated liquidation value of corporate debtors and the amounts realized by operational creditors. It is not the norm for operational creditors to consistently receive more than the liquidation value. Column D in

³⁵ Ishan Bakshi, "How the bankruptcy code is moving away from its promoter-averse approach," *The Indian Express*, (Apr. 16, 2021), <https://indianexpress.com/article/opinion/columns/insolvency-and-bankruptcy-code-amendments-modi-govt-7275456/>. (last accessed on 16-02-2024)

³⁶ *Kamineni Steel & Power India Pvt. Ltd. v. Indian Bank*, 2018 SCC OnLine NCLAT

Appendix 2 illustrates that the average liquidation value recovered by operational creditors stands at 73.39%, contrasting sharply with the average of 318.30% for financial creditors.³⁷ This discrepancy is challenging to explain, especially considering that IBC section 30(2)(b) originally mandated operational creditors to receive no less than the liquidation value. One possible explanation for this lack of correlation could be that resolution plans initially allocated collateral value to financial creditors before determining the liquidation value available for operational creditors. Alternatively, this disparity might stem from plan proponents attempting to gain Committee of Creditors (CoC) approval for plans by reallocating value away from operational creditors towards financial creditors. However, the published data does not provide sufficient insight to resolve this question.

Secondly, excluding data from one particular outlier CIRP, operational creditors on average received only 18.01% of the reported liquidation value of the corporate debtor. Once again, the published data does not offer adequate explanations for this outcome. Ultimately, if India aims to fully engage in international capital markets, it is imperative that Indian law transparently preserves the extent and priority of charges existing within the CIRP. In this regard, the proposed additions to the CIRP Regulations outlined in Part V would complement the 2019 Amendments.³⁸

4.2 Interplay of CIRP Regulations and standards of procedural fairness

In terms of the Corporate Insolvency Resolution Process (CIRP) procedure, categorizing creditors into financial and operational categories serves a pragmatic function. As highlighted by the Supreme Court in the Swiss Ribbons case, it is logical to entrust ultimate control of the process to financial creditors, who are presumed to possess more effective and efficient decision-making systems for CIRP proceedings.³⁹ This allocation of authority aligns with the envisioned time-bound nature of CIRP cases. However, while the efficiency of resolving corporate insolvency is paramount, procedural fairness should not be disregarded.

On the one hand, the Supreme Court's judgment in Essar Steel reinforced the broad power of the CoC: *The claim of a serious conflict of interest between secured and unsecured financial creditors is an argument which flies in the face of the majority of financial creditors being given complete discretion over feasibility and viability of resolution plans, which includes the manner of distribution of debts that is contained in them, subject to following the provisions of the Code. The Committee of Creditors does not act in any fiduciary capacity to any group of creditors. On the contrary, it is to take a*

³⁷Rajat Sethi, An Alternative Approach to a Code of Conduct for the Committee of Creditors in an IBC Process, S&R Associates.

³⁸ Shubham Garg, Equitable Classification of Creditors under the Insolvency Law, IBC Law, (Apr. 26, 2020) <https://ibclaw.in/equitable-classification-of-creditors-under-the-insolvency-law-by-shubham-garg/> (last accessed on 16-02-2024)

³⁹ Ibid.

business based upon ground realities by a majority, which then binds all stakeholders.

On the other hand, the Supreme Court recognizes that the IBC constrains the power of a CoC and that it is the responsibility of the NCLT to ensure those constraints are observed:⁴⁰

While the Adjudicating Authority cannot interfere on merits with the commercial decision taken by the Committee of Creditors, the limited judicial review available is to see that the Committee of Creditors has taken into account the fact that the corporate debtor needs to keep going as a going concern; that it needs to maximize the value of its assets; and that the interests of all stakeholders, including operational creditors has been taken care of.

However, if the National Company Law Tribunal (NCLT) believes that the Committee of Creditors (CoC) has overlooked these policies, the sole recourse is to send back a resolution plan to the CoC with instructions to address them. Subsequently, once the NCLT is satisfied that the CoC has duly considered these crucial aspects, it must then approve the resolution plan, provided other conditions are met.

Instead of relying on the vague policy cautions emphasized by the Supreme Court, the regulations should explicitly tackle elements of procedural fairness. For instance, the prevailing practice of CoCs engaging in negotiations with resolution applicants should be acknowledged and regulated. In the American context, the initiation of a Chapter 11 reorganization case is viewed as an opportunity for negotiation. These negotiations occur between various classes of creditors outside the jurisdiction of the Bankruptcy Court. However, the outcomes of these negotiations are eventually disclosed during the confirmation process of a reorganization plan. Conversely, in India, closed-door negotiations exclusively involving financial creditors heighten concerns regarding procedural fairness.⁴¹ Essentially, while the CoC is obligated to select the most favorable resolution plan, its negotiation process and subsequent assessment remain opaque. Consequently, evaluating the CoC's assessment of a plan that promises higher overall returns, even if it redistributes enterprise value away from operational creditors towards financial creditors, becomes challenging.

Operational creditors have legitimate grounds for apprehension regarding the terms of resolution plans when negotiations solely involve financial creditors. Furthermore, as the current situation stands, issues of procedural unfairness cannot be formally reviewed by the NCLT. On one hand, the time-sensitive nature of the CIRP process supports keeping substantive business decisions of the CoC beyond review. On the other hand, the

⁴⁰ Ernst & Young, Interpreting the Code: Corporate Insolvency in India, Mondaq, (Nov. 2016) <https://www.mondaq.com/pdf/clients/550490.pdf> (last accessed on 16-02-2024)

⁴¹ Karan Singh Chandhok, India: Restructuring & Insolvency Comparative Guide, Mondaq (Apr. 26, 2021) <https://www.mondaq.com/india/insolvencybankruptcyre-structuring/939078/restructuring-insolvency-comparative-guide> (last accessed on 16-02-2024)

regulations should explicitly grant operational creditors and unsuccessful resolution applicants the authority to raise concerns regarding procedural unfairness before the NCLT.⁴² While the Supreme Court's ruling in the Essar Steel case maintains a narrowly defined role for NCLT review, the objective of achieving procedural fairness could be better realized through the proposed additions to the CIRP Regulations detailed in the subsequent section.



⁴² Nikhil Khatri, Debtor-in-possession vs creditor-in-possession insolvency models, Mondaq, (Dec. 04, 2020) <https://www.mondaq.com/australia/insolvencybankruptcy/1013138/debtor-in-possession-vs-creditor-in-possession-insolvency-models> (last accessed on 16-02-2024)

CHAPTER 5

JUDICIAL STAND ON DIFFERENTIAL TREATMENT

The Supreme Court in many cases has analyzed the Position of operational creditor in IBC. Lets understand the positions through various case laws:

5.1 Justification of discrimination by BLRC⁴³

The differential treatment in their rights is justified by the Banking Law Reforms Committee in its report, as the drafters' objective was to safeguard the interests of all stakeholders by prioritizing debt restructuring and company revival. Only when these efforts prove futile do they consider liquidating all assets. Operational Creditors (OCs), in general, show little interest in company revival but are more inclined towards liquidation. While the Banking Law Reforms Committee elucidates the rationale behind the Code's distinction between financial and operational creditors regarding powers and priority, it does not address situations where the extensive powers conferred upon financial creditors are misused, failing to safeguard the interests of operational creditors by enforcing an arbitrary resolution.

Even in scenarios where the outstanding debt surpasses the liquidation value and all assets are exhausted in settling financial creditors and other higher-ranked groups, leaving operational creditors with no payment whatsoever, the Code remains silent.

5.2 Swiss Ribbons Pvt. Ltd. and Anr. Vs. Union of India

The pivotal case under discussion is "Swiss Ribbons Pvt. Ltd. and Anr. Vs. The Union of India and Ors,⁴⁴" which revolves around the Constitutional Validity of the "Insolvency and Bankruptcy Code, 2016" (referred to as the 'Code/IBC'). This matter was brought before the Honorable Supreme Court of India through 10 separate Writ Petitions, including a Special Leave Petition. The Supreme Court reserved and issued a combined Order on 25th January 2019.

In this significant case, the Supreme Court scrutinized the Constitutional Viability of the newly enacted Insolvency Law. Rejecting arguments challenging the validity of the Code, the Court reaffirmed the Legislative intent behind the law. It upheld the Preamble of the Code, emphasizing that the legislation does not advocate for the liquidation of the Corporate Debtor's assets as a primary recourse. Instead, liquidation is considered a last-resort solution, applicable only when a feasible resolution plan is unavailable or dismissed by either the Committee of Creditors (COC) or the National Company Law Tribunal (NCLT) itself. The Court cautioned against utilizing the Code or its principles as a means of recovery under any circumstances.

⁴³ Bhavani Rangineni, 'Operational creditors: lost in the by lanes of equality' (21st May 2021) BlogIpleaders https://blog.ipleaders.in/operational-creditors-lost-lanes-equality/#Justification_of_discrimination_by_BLRC. (last accessed on 16-02-2024)

⁴⁴ Swiss Ribbons (P) Ltd. Vs Union of India, (2019) 4 SCC 17.

The Hon'ble Court put the Last Nail in the Coffin while passing this Judgment stating that,

“The Defaulter’s Paradise is lost and, in its place, the economy’s rightful position has been Regained.”

Arguments were presented suggesting that the treatment of Financial and Operational Creditors in the Code was unfair, discriminatory, and inconsistent with Section 14 of the Constitution. In this case, the Honorable Court thoroughly examined the 2015 Report by BLRC along with relevant regulations and judgments. It concluded that the classification between types of Creditors is contingent upon the nature of their Debt, their Financial Competency, and the sufficiency of evidence required to initiate the Insolvency Process against the Corporate Debtor (CD). The Court, while considering several points, determined that the disparate treatment does not constitute discrimination and aligns with Article 14 of the Constitution:

1. Most Financial Creditors (referred to as FCs), including Banks and Financial Institutions, are Secured Creditors, whereas Operational Creditors (OCs) are Unsecured. Payments for Goods and Services or Workmen’s Compensation typically do not involve Mortgage Financing.
2. Loan Agreements with FCs differ from agreements for Goods and Services with OCs. FCs provide Finance for various purposes, including running companies, setting up new businesses, and supporting operations.
3. The number of FCs is generally fewer, but they engage in contracts involving large sums of Money compared to OCs.
4. FCs' agreements often include Repayment Schedules and Debt Covenants, violation of which may lead to debt recall and Insolvency Court proceedings for the CD, which is not the case with OCs.
5. FCs can assess the financial viability of CDs, periodically review Credit Scores, and request loan restructuring, reflecting their power and influence, unlike OCs.
6. A 'Claim' becomes a 'debt' only when it becomes 'due,' and a 'default' occurs when a 'debt' becomes 'due' and 'payable' but remains unpaid by the Debtor. FCs need to 'prove' default, whereas OCs can merely 'claim' owed sums, subject to the CoC's decision, considering only if it exceeds 10% of the CD's total Debt.

5.3 Binani Industries Limited vs. Bank of Baroda & Another

Over the past two years of implementing the I&B Code, it has become apparent that resolution plans predominantly prioritize providing maximum returns or repayments to financial creditors, while offering minimal or no payment to operational creditors. Interestingly, the I&B Code does not include provisions for operational creditors to be included in the Committee of Creditors (COC). Their only involvement is stipulated under

section 24(3)(c), which mandates that operational creditors or their representatives receive notice of COC meetings if their aggregate dues exceed 10% of the debt. Despite legal provisions and judicial precedents enabling their participation, various categories of financial and operational creditors face discrimination, with resolution plans heavily favoring financial creditors who hold voting power in the COC, to the detriment of operational creditors.

The National Company Law Appellate Tribunal (NCLAT) addressed a comparable matter in the case of Binani Industries Limited vs. Bank of Baroda & Another.⁴⁵ In this instance, the Committee of Creditors (COC) endorsed a resolution plan that outlined varying payment terms for secured financial creditors, unsecured financial creditors, and operational creditors as follows:

FINANCIAL TERMS OF RESOLUTION PLAN OF RPPL

S.N O.	PARTICULARS	VOTING SHARE	VERIFIED CLAIM (IN Rs. Crores)	PROPOSED PAYMENT (IN Rs. Crores)	PERCENTAGE	
1.	Insolvency Resolution Process Costs	N.A.	114.08	114.08	100%	
2.	Workmen Wages	N.A.	18	18	100%	
FINANCIAL CREDITORS WITH DIRECT EXPOSURE TO CORPORATE DEBTOR						
3.	Edelweiss Asset Reconstruction Company	42.9%	2775.82	2775.82	100%	

⁴⁵ Binani Industries Ltd. v. Bank of Baroda, 2018 SCC OnLine NCLAT 521

4.	IDBI Bank Limited	5.2%	335.85	335.85	100%	
5.	Bank of Baroda	6.6%	427.69	427.69	100%	
6.	Canara Bank	5.7%	370.34	370.34	100%	
7.	Bank of India	1.5%	94.66	94.66	100%	
8.	State Bank of India	0.6%	36.89	36.89	100%	
FINANCIAL CREDITORS TO WHOM CORPORATE DEBTOR WAS A GUARANTOR						
9.	IDBI Bank Limited (Dubai Branch)	24.2%	1567	1567	100%	
10	Export-Import Bank of India	9.6%	620	450	72.59%	
11.	State Bank of India (HongKong)	0.6%	37	3.7	10%	
12.	Bank of Baroda	2.7%	172	172	100%	

13.	State Bank of India (Bahrain)	0.4%	25	25	100%	
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14.	SyndicateBank	0.1%	7	7	100%	
OPERATIONAL CREDITORS (OTHER THAN WORKMEN)						
15.	UnrelatedParties	N.A.	443.23	151	35%	
16.	Related Parties	N.A.	60.14	NIL	N.A.	
17.	Statutory Liabilities	N.A.	177.50	33.10	19.3%	
18.	Equity/Working Capital Infusion	N.A.	N.A.	350	N.A.	
TOTAL			7289.05	6932.46		

IJLRA

The differential payments were contested separately by the unsecured financial creditors and the operational creditors, alleging discrimination based on their voting shares, which the Insolvency and Bankruptcy (I&B) Code does not endorse. The National Company Law Appellate Tribunal (NCLAT), in setting a precedent on this matter, determined that the primary goal of the I&B Code is resolution, aimed at maximizing the value of assets belonging to the corporate debtor for the benefit of all creditors. The intention is not to solely prioritize the interests of any particular stakeholder or group of stakeholders, such as creditors, but rather to foster entrepreneurship, facilitate access to credit, and ensure a balance of interests. The ruling underscored that the following objectives are fundamental under the I&B Code:

- a. resolution,
- b. maximization of value of assets of the corporate debtor, and
- c. promoting entrepreneurship, availability of credit and balancing the interests.

The judgment, further relying upon the report of the Bankruptcy Law Reform Committee (BLRC), and the aforesaid objectives held as follows:

1. The liabilities of all creditors who are not part of the COC must also be met in the resolution.
2. The financial creditors can modify the terms of the existing liabilities, while other creditors cannot take the risk of postponing payment for better future prospectus. That is, financial creditors can take a haircut and can take their dues in future, while operational creditors need to be paid immediately.
3. A creditor cannot maximize its own interests in view of the moratorium.
4. If one type of credit is given preferential treatment, the other types of credit will disappear from the market. This will be against the objective of promoting the availability of credit.
5. The I&B Code aims to balance the interests of all stakeholders and does not maximize value for financial creditors.
6. Therefore, the dues of operational creditors must get at least similar treatment as compared to the due of the financial creditors.

The verdict further emphasizes that a resolution plan outlines the insolvency resolution of the corporate debtor while maintaining its status as a viable entity. It does not dictate the specific details, appearance, or structure of the plan, leaving such aspects to the discretion of the involved stakeholders. The judgment clarifies that neither the Insolvency and Bankruptcy (I&B) Code nor the regulations formulated by the Insolvency and Bankruptcy Board of India (IBBI) mandate differential treatment among operational creditors or financial creditors who are in similar circumstances.

The appeal preferred by Binani Industries Limited before the Supreme Court of India in *Rajputana Properties Private Limited v. Ultratech Cements Limited* was dismissed by the Supreme Court without any detailed discussion. The Court the following order:

Having perused the judgments of the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) and after hearing learned counsel for all the parties, we are of the opinion that there is no infirmity in the order passed by the NCLAT. The appeal is accordingly dismissed. Pending applications stand disposed of.

Resultantly, the NCLAT judgment and findings with respect to the purpose of the I&B Code and discrimination between financial and operational creditors have attained finality for the time being.

The conclusion reached by the NCLAT, asserting that operational creditors' dues should receive treatment similar to those of financial creditors, cannot be universally applied without considering the specific circumstances of each case. It's crucial to acknowledge that the ruling in the Binani case was rendered under unique circumstances, wherein a rival resolution applicant proposed full repayment to both operational and financial creditors, contrasting with the COC-approved plan, which favored financial creditors over operational and unsecured creditors. Given the Supreme Court's dismissal of the appeal with restricted directives, it remains uncertain whether this matter has been definitively resolved.

Under the Insolvency and Bankruptcy Code (I&B Code), the responsibility lies with the resolution applicant to devise a plan for addressing the insolvency of the corporate debtor. However, the Binani ruling, by advocating for parity in creditor dues, limits the flexibility granted to the resolution applicant in resolving the corporate debtor's insolvency. The I&B Code does not specify the method or criteria for formulating a resolution plan. However, regulation 37 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 does provide some insight. As per this clause, a resolution proposal has the scope to facilitate the insolvency resolution of the corporate debtor with the aim of maximizing the value of its assets, encompassing various aspects such as:

- a. transfer of all or part of the assets of the corporate debtor to one or more persons;
- b. sale of all or part of the assets whether subject to any security interest or not;
- c. the substantial acquisition of shares of the corporate debtor, or the merger or consolidation of the corporate debtor with one or more persons;
- d. cancellation or delisting of any shares of the corporate debtor, if applicable;
- e. satisfaction or modification of security interests;
- f. curing or waiving of any breach of the terms of any debt due from the corporate debtor;
- g. reduction in the amount payable to the creditors;
- h. extension of maturity date or a change in interest rate or other terms of a debt due from the corporate debtor;
- i. amendment of the constitutional documents of the corporate debtor;
- j. issuance of the securities of the corporate debtor for cash, property, securities or in exchange of claims or interests or other appropriate purpose;

- k. change in technology used by the corporate debtor; and
- l. obtaining necessary approval from the central and state government and other authorities.

Hence, a resolution applicant has the freedom to propose various measures for resolving insolvency, and this doesn't automatically necessitate uniform treatment for the debts owed to operational creditors or financial creditors. It's important to note the overarching objective outlined in the long title of the I&B Code, which emphasizes achieving a 'balance of interests of all stakeholders' during the insolvency process. Therefore, as long as a resolution plan maintains this balance, which may or may not involve equal treatment of debts owed to financial and operational creditors, it remains legally valid. In essence, while the Binani judgment offers hope to operational creditors and signifies a step forward, it may still require time for the legal landscape to settle this issue and provide the necessary clarity.

5.4 Committee of Creditors (CoC) of Essar Steel Vs. Satish Kumar Gupta

The legal battle between the Committee of Creditors (CoC) of Essar Steel and Satish Kumar Gupta⁴⁶ concluded with a final verdict on November 15, 2019, after a series of petitions filed in the Supreme Court. The judgment was delivered by a Bench comprising Justices Rohinton Nariman, Surya Kant, and V Ramasubramanian. The case, which began nearly two years ago, aimed to resolve the conflict between the financially troubled Essar Steel and its Committee of Creditors.

The case began on August 2nd, 2017, when Essar Steel, burdened with debts amounting to ₹54,547 crores owed to both financial and operational creditors, was declared insolvent. The company's financial troubles had led to its identification as one of the largest corporate defaulters by the Reserve Bank of India (RBI). Subsequently, creditors, led by a consortium comprising Standard Chartered and State Bank of India, along with Numetal, Vedanta, JSW Steel, and others, filed an insolvency application under Section 7 for the Corporate Insolvency Resolution Process (CIRP) at the Ahmedabad Bench of the National Company Law Tribunal (NCLT), which was admitted.

The bid by ArcelorMittal, led by Lakshmi Mittal in partnership with Nippon Steel and Sumitomo Corporation, marked the culmination of the race to acquire the assets of debt-ridden Essar Steel by offering a total of ₹50,000 crores, including an equity infusion of ₹8,000 crores. However, the resolution plan faced challenges after its approval by the NCLT (Ahmedabad Bench) in March 2019. Operational creditors (Dakshin Gujarat, Gujarat Energy, Bharat Petroleum, Indian Oil, GAIL, ONGC, and NTPC) contested the plan, arguing that they were only receiving 8% from the resolution plan compared to financial creditors recovering 92.5% from the recovered amount. Additionally, Standard Chartered Bank and the directors of Essar Steel also challenged the bid, alleging violations.

⁴⁶ Committee of Creditors of Essar Steel India Limited (through authorized signatory) v. Satish Kumar Gupta and Others, (2020) 8 SCC 531

The decision of the NCLT was contested and subsequently reviewed by the National Company Law Appellate Tribunal (referred to as "NCLAT") through a series of petitions. In its ruling dated July 4, 2019, the appellate tribunal approved the plan put forth by the Committee of Creditors (CoC) but mandated that both Financial Creditors (FCs) and Operational Creditors (OCs) should receive no less than 60.7% of their total dues (exceeding 1 crore in value). Moreover, the NCLAT determined that OCs with claims below 1 crore were entitled to receive full payment of their dues, thereby increasing the total debts of the company from ₹54,547 crores to ₹69,192.34 crores. Additionally, the NCLAT affirmed that there should be no discriminatory treatment between FCs and OCs by the CoC. The resolution plan, as presented to the Resolution Professional, allocated ₹1,200 crores to OCs compared to their claim of ₹4,976 crores, while Standard Chartered Bank was slated to receive ₹60.71 crores out of its ₹3,500 crores investment. This allocation was contested in the NCLAT, which ruled that both FCs and OCs should be treated equally.]

Following the ruling by the NCLAT, the group of banks headed by SBI appealed to the highest court. The decision of the NCLAT was contested by the Committee of Creditors (CoC), arguing that Financial Creditors (FCs) hold precedence and are entitled to a higher recovery than Operational Creditors (OCs). The Supreme Court concurred with the perspective of the CoC and overturned the NCLAT's order, thereby concluding the protracted dispute that lasted for 830 days.

The Supreme Court affirmed that the Committee of Creditors (CoC) holds the authority to make final determinations regarding the allocation of funds received from the recovery amount, emphasizing the CoC's supremacy in fund disbursement under the Insolvency and Bankruptcy Code (IBC). This ensures that the Resolution Professional operates within the legal framework of the Code, striving to achieve a balanced outcome for all stakeholders, including operational creditors. The CoC's decisions regarding fund distribution and modifications to the Resolution Plan (RP) are binding, contributing to the feasibility and viability of the Corporate Insolvency Resolution Process (CIRP). The court clarified that neither the adjudicating authority, i.e., the National Company Law Tribunal (NCLT), nor the appellate authority, i.e., the National Company Law Appellate Tribunal (NCLAT), can intervene in the CoC's decisions under Sections 30(2) and 32 read with Section 61(3) of the IBC. However, these authorities are entitled to make recommendations for the proper implementation of the plan.

Furthermore, the court acknowledged that the strict 330-day deadline for completing the CIRP may not always be feasible and could infringe upon litigants' fundamental rights under Articles 14 and 19(1)(g) of the Constitution. Hence, flexibility is permitted in exceptional circumstances, and the word "mandatory" has been omitted from Section 12(3) of the provision. Additionally, the court affirmed that the rights of Financial Creditors (FCs) take precedence over Operational Creditors (OCs) in fund distribution, as FCs are the primary investors and providers of capital to the company, while OCs are secondary

beneficiaries. The court also addressed issues concerning unsecured lending, emphasizing that the proportional recovery of debt between OCs and FCs need not be equal but equitable.

Regarding the role of the Resolution Professional in the CIRP process, the court clarified that it is administrative rather than adjudicatory. While the CoC's decisions hold sway in all circumstances, the Resolution Professional acts as an advisor, ensuring that submitted resolution plans are comprehensive and compliant with the provisions of the Code.

CHAPTER 6 STAKEHOLDER PERSPECTIVE

6.1 Comments From Government

Dr. Krishnamurthy Subramanian, Chief Economic Adviser to the Ministry of Finance, Government of India, remarked during the CII National Conference on '5-Years of the IBC & Way Forward' held on August 27, 2021, that the enactment of the Insolvency and Bankruptcy Code (IBC) in 2016 has played a pivotal role in harmonizing the interests of various stakeholders, thus establishing a⁴⁷ conducive and equitable environment for resolving insolvency matters in the present era. He noted that prior to the implementation of the IBC, the legal landscape governing insolvency and restructuring procedures for corporate entities, partnership firms, and individuals in India was convoluted and fragmented across numerous legislations.

The Code has introduced a unified mechanism for resolving insolvencies in the country, striking a delicate balance among all stakeholders to safeguard the economic value of the process within stipulated time frames.⁴⁸

6.2 Comments from Legal Luminaries

Addressing the inaugural session of the National Conference, Chief Justice (Rtd) M M Kumar, Member of the NHRC and Former President of NCLT, expressed his opinion that the IBC has brought about a transformative change in the resolution of distressed assets. He highlighted the shift from a debtor-centric approach to a creditor-centric one under the Code, wherein creditors are empowered with the possession and management of assets through insolvency professionals. Kumar emphasized the interconnectedness of the IBC

⁴⁷ (2021) CII Media Releases. Available at:

<https://www.cii.in/PressreleasesDetail.aspx?enc=EbbRUXEaOxkV2TRpJPLTKsN7Y8LclcbX8vrvJLlxLUHOqKRLRa3fMBkslcABcg81rdtvaiMhhuMgZk2ER7Mq4tmgGr8k%2Fq6UFv0LwcyAk7OSZDuFsMUuxKDFqGnX2n091LScevl%2FvjSzqfty+pyghDDOT81mcDDT00WEbLteeKBT6aYVBZF9qTV6Z+lJFsPssHGZVxRt4hq9wNa5If9vwcUfa2tiGEJ91FrJiO1SmMkCcicyQBldrVlywRQuqgm49lsP81IVgR5fk46w5zrpU4MLELGeBZ9skEuMn0RIHh5IQTvYDIPpvV2H1tQvE594wulGVPpluzD9GIDKpw+PZozv1ON0yOTaOTvwMMLzhZ0%3D> (Accessed: 23 March 2024). (last accessed on 16-02-2024)

⁴⁸ Ibid.

with other legal domains such as Company Law and the Law of Contract, underscoring the necessity of a holistic understanding of these areas.⁴⁹

Despite being a relatively recent legislation, Kumar observed that the IBC has undergone several amendments within a short timeframe to address any loopholes or ambiguities that could impede its smooth operation. He acknowledged the pivotal role played by relevant authorities and legislative think-tanks in introducing new dimensions to the law within stringent timelines, thereby clarifying critical amendments⁵⁰ in the evolving landscape of insolvency resolution.

Sudip Mahapatra is a Partner at S&R Associates, Pooja Singhania is a Senior Associate at S&R Associates and Misha Chandna is an Associate at S&R Associates highlighted in her paper that⁵¹

“Despite being relatively nascent, the IBC has already succeeded in bringing about a substantial change in the existing culture of borrower impunity and lack of recourse for creditors plaguing the Indian banking sector. However, such success appears to be at the cost of the interests of other stakeholders, particularly operational creditors. In Essar Steel, the Supreme Court upheld the constitutionality of the amendments to the IBC, which grant the CoC considerable powers to decide matters related to the distribution of funds among creditors under a resolution plan. In a marked shift from its previous position, the Supreme Court found a stark difference in recovery between the operational creditors and the financial creditors to be ‘equitable’. The Supreme Court has attempted to afford some protection to operational creditors by requiring the CoC to ‘take into account’ the interests of such creditors when exercising its commercial wisdom. It has also empowered the NCLT to ensure such compliance.

However, the extent of such protection remains questionable given that the ‘commercial wisdom’ of the CoC continues to retain primacy. The Essar Steel ruling strikes at the heart of the stated aim of the IBC to “balance the interests of all stakeholders”.⁴⁸ A resolution process would necessarily entail a compromise on the part of the creditors in respect of their dues. This would obliterate all the rights and remedies in respect of the claims of the operational creditors (including disputed claims). Such an obliteration of rights without any due process would not serve either the stated objectives of the IBC or the larger public interest. In the view of the authors, potential solutions to ensure more equitable treatment of operational creditors need to be considered by both the legislature as well as the insolvency tribunals and courts. The present framework, which leaves the manner of

⁴⁹ J, S. (2024) Swaminathan J: Resolution of stressed assets and IBC – The Future Road Map, The Bank for International Settlements. Available at: <https://www.bis.org/review/r240117g.htm> (last accessed on 16-02-2024).

⁵⁰ Ibid.

⁵¹ Sudip Mahapatra, P.S. & M.C. (2020) Operational creditors in insolvency: A tale of disenfranchisement, Live Law. Available at: <https://www.livelaw.in/law-firms/articles/operational-creditors-in-insolvency-a-tale-of-disenfranchisement-160906> (Accessed: 23 March 2024).

treatment of dues of operational creditors to the CoC consisting of financial creditors withan evident conflict of interest, is patently inadequate. One possible solution is to allow forthe participation of operational creditors in the decision-making process including for theapproval of a resolution plan in line with international practice. This would add an elementof fairness to any haircut on their dues under a resolution plan and incentivise resolution applicants and financial creditors to ensure equitable treatment of their dues. Lastly, the IBC and the Supreme Court disregard the interests of creditors with ‘disputed’ claims by failing to provide any mechanism to quantify and admit such claims in an insolvency resolution process.

In the view of the authors, the RP should be given the same powers as a liquidator to ‘estimate’ disputed claims or the NCLT should be conferred with the first instancejurisdiction to assess such claims. Such provisions for the estimation and admission of disputed debt would also be more in accord with the scheme and objectives of the IBC andin keeping with the practice followed in other jurisdictions.”

Raj Bhalla, a partner at law firm MV Kini has an opinion that⁵²

“In recent times, operational creditors have been observed to be initiating insolvency process to recover the debt owed to them. The petitions before the NCLT (National Company Law Tribunal), show a tendency to use the law by small creditors as a debt collection tool rather than for rehabilitation of non-performing assets by the banks, therebyundermining its objective, an operational creditor, who is not entitled to a voting share inthe committee of creditors, files a petition for insolvency under Section 9 of IBC, with the intention to reach a settlement with a company, despite being aware that they might not get anything in the resolution plan. This tendency to settle through insolvency proceedingsis clear from the IBBI data. Over 19% of all insolvency cases initiated by operational creditors have been closed via appeals, reviews or have been settled. The number is 9% for financial creditors, the data showed.”

Abhishek Swaroop, a partner at Saraf & Partners highlights that

“Stressed operational vendors do not have the ability or wherewithal to await delayed recovery through regular civil or arbitration proceedings. Therefore, they take this shortcut to enforce some sort of recovery. This is the reason we are witnessing a surge in operational creditor filings cases more than financial creditors,”

Sharad Tyagi, a partner at Fair & Just Legal Solutions LLP highlights that

“The Insolvency and Bankruptcy Code, 2016 (“IBC”) is considered as an important legislation for early detection of financial sickness of any corporate debtor and to deal

⁵² Ghosh, S. (2022) *Operational creditors lead in filing bankruptcy cases, mint*. Available at: <https://www.livemint.com/news/india/operational-creditors-lead-in-filing-bankruptcy-cases-11661531718852.html> (Accessed: 23 March 2024).

with such sickness in a time bound manner by allowing the implementation of the effective resolution plan, if the same is viable. After the detection of such sickness, all decisions pertaining to revival and implementation of the effective resolution plan are required to be taken by the committee of creditors (comprising of only financial creditors) ("CoC") by majority vote of not less than 66% of the voting share of the financial creditors. The operational creditors are not allowed to be a part of CoC and to vote in favour or against such resolution plan except when there is no financial creditor pertaining to the corporate debtor and such operational creditors meet the prescribed criteria under IBC. Such operational creditors have limited rights to receive notice of CoC meeting and to attend such meeting provided their aggregate dues are at least equivalent to 10% of the total debt.

The Bankruptcy Law Review Committee ("Committee") in its report dated November 4, 2015, has expressed its apprehension that the operational creditors would not be willing to take the risk of postponing their payments for better future prospects of the corporate debtor and concluded that the constitution of CoC should be restricted only to the financial creditors for rapid and efficient resolution process. The aforesaid rationale seems to be against the interest of the operational creditors as no business can sustain without incurring operational debt and there is a possibility that such operational creditors will start demanding upfront payment or security to protect their interest which may badly affect the business of the operational creditors.

In the matter of Binani Industries Limited Vs Bank of Baroda & Anr. [Company Appeal (AT) (Insolvency) No. 82 of 2018], it is inter alia mentioned that "...if one type of credit is given preferential treatment, the other type of credit will disappear from market. This will be against the objective of promoting availability of credit".

The rationale given by the aforesaid Committee regarding exclusion of operational creditors in CoC seems logical, but such scenario will not fit in all the cases of corporate bankruptcy. For example, if few operational creditors hold 75% of the total debt, still they will not be having any decision-making power in CoC which seems to be unfair to such operational creditors. Thus, there must be some criteria under IBC based on which such operational creditors may also be included in CoC or else it should be left to the discretion of National Company Law Tribunal to include them in CoC with voting rights."

6.3 Comments from Industry

Anthony Casey, Researcher at the Finance Research Group, highlights that,⁵³

"The exclusion of operational creditors from the decision-making process was partly based on the rationale of minimising specific costs associated with including them. Two in

⁵³ Haircut under IBC rises to 60% in fiscal 2021, half the closes cases liquidated - ET BFSI (2021) ETBFSI.com. Available at: <https://bfsi.economictimes.indiatimes.com/news/banking/haircut-under-ibc-rises-to-60-in-fiscal-2021-half-the-closes-cases-liquidated/83140859> (Accessed: 23 March 2024).

particular loom large. First, operational creditors are widely dispersed and collecting and admitting their claims can be expensive and time consuming. Similarly, these creditors often have widely disparate interests, making it difficult to deal with them as a single class. For instance, the interests of a supplier who has made a large one-time sale to a debtor will be starkly different from the interests of an employee or a long-term supplier. Similarly, the interests of a home-buyer will be different from the interests of the government, which is also an operational creditor in connection with statutory dues. Countries that include all creditors in the voting process often do so through elaborate mechanisms of committee representation, claims processing, and debt trading. These mechanisms come at a cost, and the reality is that they often provide little protection. For example, in the US, despite robust mechanisms for unsecured creditors to participate in the decision process, those creditors often recover little or nothing. Second, operational creditors tend to have a strong anti-liquidation bias, making their vote – when actually coordinated – a threat to efficient decision making. Operational creditors recover near the bottom of the liquidation waterfall and have little to gain in liquidation. At the same time, any project that might produce a future payout – no matter how risky – can increase their payout and continue their valuable relationship with the debtor. This reinforces their bias towards an overall sub-optimal resolution. What might be the costs of excluding operational creditors? Theoretically, financial creditors, especially secured creditors, may be biased toward liquidation as it offers them a chance to keep their security outside the debtor's estate, and the lack of voice for operational creditors in the process might reduce their recovery rates in bankruptcy. Reduced recoveries could, in turn, lead to higher costs of trade credit for firms nearing distress as vendors charge higher fees or require advance payments at the earliest signs of distress. Reduced recovery could also lead to the collapse of a vital vendor, speeding up the deterioration of the financial health of the distressed debtor. Every insolvency system in the world struggles to balance these competing forces. Notably, though, the balance is difficult only if operational creditors actually get a raw deal when they are excluded from the voting process. And there is reason to think that this is not the case. For example, operational creditors seem to favour the IBC over other alternatives. They are now the most common group to initiate a resolution process under the IBC. Out of the roughly 1,800 resolution processes that we have seen so far, a little more than half have been initiated at the behest of operational creditors. And, the available data suggests that from January 2017 to March 2019, the number of processes initiated by operational creditors has been increasing by an average of 109 per cent every quarter. The corresponding average for the number of processes initiated by financial creditors is 75 per cent. Even more tellingly, the Insolvency and Bankruptcy Board of India's (IBBI's) affidavit filed with the National Company Law Appellate Tribunal suggests that recoveries for operational creditors are marginally more than those for financial creditors. The IBBI's published data on recovery rates for 66 completed resolution processes as in December 2018 shows that on an average, operational creditors have recovered 47.45 per cent of their admitted claims. The corresponding number for financial creditors is 45.83 per cent. And, these

rates do not take into account the benefit that most operational creditors realise by maintaining their ongoing relationships with reorganised debtors.

Bhargavi Zaveri, Head of Compliance at Jindal Steel highlights that⁵⁴

The claims of operational creditors being treated unfairly in the resolution process. These strong recoveries are not as surprising as one might initially think. Financial creditors have strong incentives to treat operational creditors fairly. The best path for financial creditors to maximise recovery is often a reorganisation that keeps the firm alive as a going concern. That requires that the firm's operations run smoothly, which is not possible without ongoing relationships with operational creditors such as vendors, employees, and clients. Finally, to truly assess the merits of the IBC's voting structure, we have to ask how outcomes would differ under alternate regimes where operational creditors are given a vote. Again, there is reason to think that the IBC is no worse for operational creditors than the alternatives. Even with voting rights, the operational creditors still face coordination problems. And in many cases, it is unlikely that they would have an effective vote in the decision-making processes. Given the current 66 per cent threshold and the structure of the debt market in India, their vote would likely hold little or no sway in most cases.

For operational creditors' vote to really matter, voting rules would likely have to introduce class voting and costly coordination mechanisms. Class voting then requires even more expensive processes for dealing with hold-out classes, such as the cram-down mechanism in the US. And for all the added costs in those systems, the practical results are often the same where the votes of unsecured creditors have no practical effect on the outcome. In the end, there is much uncertainty. To assess whether the concerns — and the responses to them — are valid, we must first evaluate potential costs and benefits of excluding operational creditors from the decision-making process of the creditors' committee. Any decision to change the system should be based on developed theory and firm evidence. As it stands, the theory and available evidence point in favour of the current system and against popular claims of unfairness towards operational creditors.”

Rajesh Narain Gupta, managing partner at SNG highlights that,⁵⁵

“The large number of cases from operational creditors have now led to fears that the system may be misused because once a case is filed, all other recovery cases are stalled. The insolvency professional also has to be equipped to manage the company not only in terms of daily operations but also with regards to things like tax,”

⁵⁴ Ghosh, S. (2022a) *Operational creditors lead in filing bankruptcy cases*, mint. Available at: ><https://www.livemint.com/news/india/operational-creditors-lead-in-filing-bankruptcy-cases-11661531718852.html>> (Accessed: 23 March 2024).

⁵⁵ Ibid.

Chapter 7

GLOBAL POSITION OF INSOLVENCY REGIME

However, the execution of Indian insolvency law varies from that of its counterparts. For instance, India has adopted a 'creditor-in-control system' inspired by the previous United Kingdom insolvency framework. Conversely, the United Kingdom has transitioned to a 'debtor-friendly approach' following the enactment of the Corporate Insolvency and Governance Act, 2020. Similarly, the United States of America operates under a 'debtor-in-possession' regime, akin to the current framework in place in the United Kingdom. Let's consider a hypothetical scenario involving two companies, Company A and Company B, both facing financial distress.

Under the Indian insolvency law, Company A's creditors have significant control over the insolvency proceedings. The creditors, collectively forming the Committee of Creditors (CoC), play a pivotal role in determining the fate of the company by evaluating and approving resolution plans. This 'creditor-in-control' model empowers creditors to influence decisions regarding the restructuring or liquidation of the company.

On the other hand, in the United Kingdom, Company B operates under a different insolvency regime following the implementation of the Corporate Insolvency and Governance Act, 2020. Under this new legislation, the focus shifts towards facilitating the survival of distressed companies. Company B's management retains control during insolvency proceedings, adopting a 'debtor-friendly approach'.⁵⁶ The directors have the opportunity to initiate a standalone moratorium, providing them with time to devise a strategy to rescue the company while shielding it from creditor actions.

In contrast, in the United States, Company C navigates through insolvency proceedings under a 'debtor-in-possession' regime.⁵⁷ Here, the company's management retains control and operates the business while under Chapter 11 bankruptcy protection. This allows the company to continue its operations and negotiate with creditors to restructure its debts and emerge from bankruptcy as a viable entity.

7.1 United Kingdom

The Indian insolvency system shares several similarities with that of the United Kingdom. Both countries allow both creditors and debtors to initiate bankruptcy procedures. Additionally, both Indian and UK laws establish deadlines for the completion of proceedings, albeit with variations in the specific timelines.⁵⁸ Both nations have established self-regulatory bodies—the Insolvency and Bankruptcy Board of India (IBBI) in India and

⁵⁶ James Watson, UK: Restructuring & Insolvency Comparative Guide, Mondaq, (Feb. 22, 2021)

<https://www.mondaq.com/uk/insolvencybankruptcyre-structuring/939090/restructuring-insolvency-comparative-guide> (last accessed on 16-02-2024)

⁵⁷ Donald S. Bernstein, Timothy Graulich, Christopher S Robertson and Thomas S Green, The Insolvency Review: USA, The Law Reviews (Nov. 18, 2020) <https://thelawreviews.co.uk/title/the-insolvency-review/usa>

⁵⁸ Troy Segal, Corporate Bankruptcy: An Overview, Investopedia, (May 31, 2021) <https://www.investopedia.com/articles/01/120501.asp>

professional bodies such as ICAEW and ACCA in the UK—to ensure the smooth operation of the insolvency process.

Previously, another significant similarity between the two countries was the 'creditor in control scheme.' However, due to the impact of the Coronavirus pandemic, the UK has introduced the Corporate Insolvency and Governance Act 2020. This Act includes provisions akin to the 'debtor in possession' system employed in the USA, along with substantial revisions to the UK's previous insolvency legislation. The Corporate Insolvency and Governance Act 2020, effective from June 26th, 2020, notably shifts the balance in favor of debtors within traditionally creditor-oriented bankruptcy laws. In the UK, the Act introduces a new standalone moratorium procedure that allows directors to retain control while devising strategies to sustain the company as a going concern.

A key reform under the English Insolvency regime introduced by the Corporate Insolvency and Governance Act 2020 is the ability for directors to apply for a standalone moratorium lasting an initial term of 20 business days. During this period, directors retain control, while a professional insolvency practitioner assumes the role of a "monitor," overseeing the company's operations. The purpose of the moratorium is to shield the company from adverse creditor actions temporarily, enabling directors to reorganize and rescue the company.

Another significant reform under the Corporate Insolvency and Governance Act 2020 pertains to restructuring plans.⁵⁹ In both the UK and India, plans of arrangement are only enforceable if approved by each class of creditors and members (shareholders). However, under the CIGA, a court can sanction a restructuring plan that binds dissenting classes of creditors or members (known as "cross-class cram down") if deemed equitable to such creditors. Similar cross-class cram down provisions exist in India, where operational creditors and shareholders are bound by a resolution plan approved by a two-thirds majority of financial creditors. The Supreme Court of India has also upheld the validity of cross-class cram down, provided that operational creditors are treated fairly and equitably.⁶⁰

7.2 United States of America

In the United States of America, bankruptcy laws revolve around the concept of debtor-in-possession. Currently, the bankruptcy system in the United States is governed by Title 11 of the United States Code, known as the Bankruptcy Code. One significant similarity between the US and Indian insolvency frameworks is the absolute priority rule, which dictates that secured creditors must be fully compensated before unsecured claims are settled, with shareholders having the lowest priority and receiving compensation only after

⁵⁹ CRI Education Inc., Debtor in Possession (DIP), Corporate Finance Institute <https://corporatefinanceinstitute.com/resources/knowledge/credit/debtor-in-possession-dip/> (last accessed on 16-02-2024)

⁶⁰ L. Viswanathan, Gaurav Gupte, UK's Insolvency Reforms can show India the way, Live Mint, July 22, 2020, <https://www.livemint.com/opinion/online-views/uk-s-insolvency-reforms-can-show-india-the-way-11595430383515.html> (last accessed on 16-02-2024)

all creditors have been paid.⁶¹ Additionally, both jurisdictions implement a moratorium, which is automatically activated upon the initiation of bankruptcy proceedings.

However, there are notable distinctions between the two systems. The fundamental concept of insolvency laws varies: India's system leans towards a creditor-friendly model, whereas the US system leans towards a debtor-friendly approach.⁶² In the United States, insolvency legislation aims to restructure rather than liquidate debtors, typically through reorganization under Chapter 11 of the Bankruptcy Code. Alternatively, if reorganization is unfeasible, the debtor corporation may undergo liquidation under Chapter 7 of the Bankruptcy Code. During liquidation, the debtor's management surrenders control to a trustee appointed by the United States Trustee or chosen by the debtor's creditors under Chapter 7.

Consequently, the fundamental difference between the two regimes lies in the United States' debtor-friendly strategy contrasted with India's creditor-friendly approach. Under the US statute, the debtor retains possession, while in India, an Interim Resolution Professional is appointed to oversee the Resolution process. In the United States, the debtor retains the authority to disclaim, adopt, or transfer any contracts, similar to their prerogatives prior to bankruptcy. Conversely, in India, an Interim Resolution Professional cannot modify contracts without the consent of the creditors' committee.

7.3 Lessons from UK and USA

There are few lessons which India can adopt from USA and UK are:

1. Court endorsement of a Pre-pack: A parallel can be drawn between the authority of the NCLT in India and a bankruptcy judge in the US—both hold significant discretionary power in the restructuring process of a debtor. Given the skepticism towards out-of-court settlements in India, the NCLT's validation of a Pre-pack or the potential to reopen a Pre-pack cannot be disregarded. Nonetheless, the discretionary authority of the NCLT can be regulated. Currently, the NCLT and NCLAT operate under the principles of natural justice and are bound by the provisions and regulations set forth in the Indian Companies Act, 1956/2013.

In the US, primary bankruptcy jurisdiction resides with district courts; however, each district court may issue an order of reference whereby the matter is referred to a specialized bankruptcy court. These bankruptcy courts are presided over by dedicated bankruptcy judges who have the authority to identify core matters related

⁶¹ See, e.g., 11 U.S.C. § 303(h)(1) (2019) (triggering admission of an involuntary petition is not paying "debts as such debts become due"). Chapter 11 of the United States Code (U.S.C.) is the United States Bankruptcy Code.

⁶² Dhruvi Chheda, Shivani Kapur Jeet, Nasrin Shaikh, Vidit Mehra, Nuances Under The Insolvency And Bankruptcy Code, 2016, Mondaq (July 02, 2021),

<https://www.mondaq.com/india/insolvencybankruptcy/1087164/nuances-under-the-insolvency-and-bankruptcy-code-2016?type=mondaqai&score=78> (last accessed on 16-02-2024)

to bankruptcy and issue final judgments or orders on them. Considering the uniqueness of Pre-packs and the specialized market for them in India, it would be more prudent to delegate approval authority to a specialized court with bankruptcy judges specifically equipped to evaluate a Pre-pack resolution plan.⁶³ Such a specialized court could be established as a subset tribunal of the NCLT and tasked with ensuring that the fundamental principles of the Corporate Insolvency Resolution Process (CIRP) are upheld while restructuring the debtor's business within a limited timeframe. Alternatively, another approach could involve leveraging the expertise of an Interim Resolution Professional (IRP), as discussed below.

2. **Regulating Interim Resolution Professionals (IRPs):** In the Indian insolvency framework, IRPs share similarities with administrators in the UK. However, when it comes to Pre-packs, it would be more beneficial to align the role of an IRP with that of a US trustee. Unlike creditors, the US Trustee does not have a direct economic stake in bankruptcy proceedings but serves a crucial oversight function, somewhat akin to an impartial observer, in assisting bankruptcy judges in their duties efficiently and effectively. While the US Trustee does take positions on various issues in bankruptcy cases it is involved in, its primary objective is to facilitate the smooth functioning of the bankruptcy process as a whole.

In the context of Pre-packs in India, an IRP can be appointed at the debtor's discretion upon recommendation by a creditor or any other stakeholder to oversee the Pre-pack process. Similar to a US Trustee, in a Pre-pack scenario, an IRP can assume the role of an overseeing officer, allowing the debtor to continue managing its business while overseeing it to ensure compliance with the Insolvency and Bankruptcy Code (IBC) or bankruptcy norms. If the debtor and its creditors fail to appoint an IRP during the Pre-pack process, the NCLT can appoint one once the Pre-pack is finalized among the debtor, creditors, and other stakeholders.⁶⁴ The appointed IRP would then review the Pre-pack plan and the process through which it was achieved, ensuring it is free of any fraudulent activities or misconduct on the part of the debtor. Before Pre-packs can be introduced in India as a method of corporate rescue, the IBC will need to undergo further amendments to delineate the powers and responsibilities of an IRP in a Pre-pack transaction. Guidance from the Statements of Insolvency Practice 16 (SIP 16) applicable in the UK may be sought as it delves into the specificities of the role of an IRP in a Pre-pack scenario.

3. **Treatment of Creditor Classes:** The Pre-pack procedure in India will be carried out by the debtor in collaboration with creditor approval. To ensure creditor cooperation and dissuade objections to the Pre-pack process, it's crucial to offer

⁶³ Norton Rose Fulbright, The UK Corporate Insolvency and Governance Act 2020: A move to a more debtor-friendly restructuring regime? Norton Rose Fulbright (July 2020)

<https://www.nortonrosefulbright.com/en/knowledge/publications/5ac21a15/the-uk-corporate-insolvency-and-governance-act-2020> (last accessed on 16-02-2024)

⁶⁴ Ibid

them reasonable incentives to opt for Pre-pack instead of resorting to the Corporate Insolvency Resolution Process (CIRP). One effective approach would involve initially securing the consent of these creditor classes for Pre-pack, with the understanding that it will lead to a more efficient court-driven CIRP later. Once mutual consent for Pre-pack is obtained, creditors must also agree to implement a 'self-regulated automatic stay/moratorium' on themselves until the conclusion of the Pre-pack negotiation process and the filing of the CIRP application in the NCLT. In terms of the treatment of creditor classes, it's imperative to adopt the concept of impaired and unimpaired classes of creditors from the US and assign roles accordingly. Since secured creditors, i.e., financial creditors, are positioned at the higher end of the pyramid in the waterfall structure outlined under the IBC, it's logical to classify them as unimpaired classes as long as their debt is fully repaid, in accordance with the terms of their respective loan agreements. The unimpaired class will be assured of full repayment of their debt along with the promised interest (or possibly even higher interest to incentivize participation) and will be required to give primary consent to the Pre-pack. On the other hand, other creditors—such as unsecured creditors, small claim holders, and operational creditors—who rank lower in the waterfall, could be categorized as impaired classes. Only impaired classes of creditors will have the right to object to the Pre-pack at any stage of the negotiation. Additionally, creditors or stakeholders may request the appointment of an IRP at any stage to prevent any misconduct by the debtor.⁶⁵

It's evident that the debtor, along with an appointed IRP if they choose to do so, will bear the significant responsibility of coordinating among all creditor classes, maintaining credibility throughout the Pre-pack process, and preventing any incidents that may jeopardize the interests of the creditors.

4. Sale of Assets and Connected Party Pre-packs: In 2014, confronted with a similar challenge regarding connected party Pre-packs, the UK government established a review committee—the Graham Committee—to scrutinize the Pre-pack process. The Graham Committee proposed the creation of a pool of independent business professionals tasked with evaluating the Pre-pack devised by the debtor, including the sale of assets during the Pre-pack process. Following the Graham Committee's recommendations, SIP 16 was amended in November 2015 to introduce the Pre-pack pool, aiming to enhance transparency in Pre-packs.⁶⁶ A comparable pool of professionals could be established to assess the business decisions made by the debtor throughout the Pre-pack process. This Pre-pack pool would review asset sale determinations and any connected party transactions sought by the debtor. If the Pre-pack pool identifies that the debtor's insolvency can be attributed to

⁶⁵ Ibid.

⁶⁶ Maya Dollarhide, Chapter 11, Investopedia, (Apr. 23, 2021) <https://www.investopedia.com/terms/c/chapter11.asp>.

mismanagement by the board and promoters, such connected party transactions would not be validated.

However, a significant challenge in implementing this regulation would be determining the appropriate stage for the Pre-pack pool's intervention. Subjecting every business decision to the Pre-pack pool's approval during the negotiation phase might compromise the confidentiality of the Pre-pack. Conversely, reviewing such decisions after their implementation would have minimal impact and could lead to complexities in unwinding transactions if necessary.

At this juncture, the voluntary appointment of an IRP by the debtor takes on even greater significance in upholding transparency and instilling confidence among Pre-pack participants. An IRP could oversee the Pre-pack process and report any suspected fraudulent conveyances to the Pre-pack pool for review and approval. Through voluntary appointment of an IRP alongside the Pre-pack pool, it can be ensured that all business transactions during the Pre-pack process adhere to arm's length principles, serve the interests of creditors and stakeholders, and comply with the IBC.⁶⁷



⁶⁷ CRI Education Inc., Debtor in Possession (DIP), Corporate Finance Institute <https://corporatefinanceinstitute.com/resources/knowledge/credit/debtor-in-possession-dip/> (last accessed on 16-02-2024)

CHAPTER 8

POSSIBLE SOLUTIONS AND WAY FORWARD

8.1 Safeguards stipulated under Section 230 of the Companies Act, 2013

The concept of a "resolution plan" is not novel, as similar schemes have existed under various legislations such as the Sick Industries (Special Provisions) Act, 1985 (SICA), Company Voluntary Arrangements under the UK Insolvency Act, 1986, or repayment plans under the US Bankruptcy Code. However, schemes of arrangements or compromises under the Companies Act, 1956/2013 differ slightly, as they require every class to agree collectively to the arrangement or compromise. A super-majority within each class determines the acceptance of the compromise/arrangement, binding the entire class, including both assenting and dissenting members, who have been given separate consideration.⁶⁸

The provisions and principles followed in regimes like SICA, or in jurisdictions such as the UK and US, could offer potential solutions to the current issue at hand. That is, the overarching effect of the resolution plan shall be subject to certain safeguards and principles as discussed below –

Section 230 of the Companies Act, 2013, offers more detailed provisions compared to its predecessor, Section 391 of the Companies Act, 1956. It includes various safeguards for creditors who may be left out of the restructuring process. For instance:

- a) In a corporate debt restructuring scheme approved by at least 75% of the secured creditors by value, the applicant must incorporate measures to protect other secured and unsecured creditors.
- b) Notices of proposed meetings under Section 230 must be sent individually to all creditors, members, and debenture-holders of the company or their respective classes. These notices should include comprehensive information about the compromise or arrangement, any valuation reports, and their implications for various stakeholders. If meeting notices are also advertised, they must specify the timeframe within which relevant documents will be available free of charge from the company's registered office.

Additionally, Sub-section (6) of Section 230 states that if a compromise or arrangement is approved by a majority representing three-fourths in value of the creditors, members, or their respective classes, and is subsequently sanctioned by the Tribunal, it becomes legally

⁶⁸ Singh, G., Need for Judicial Scrutiny of the Commercial Wisdom of COC, The Indian Review of Corporate and Commercial Laws (IRCCCL) (available at: <https://www.ircl.in/post/need-for-judicial-scrutiny-of-the-commercial-wisdom-ofcoc>). (last accessed on 16-02-2024)

binding on the company, all creditors, members, or their classes, and in the case of a winding-up, on the liquidator and the contributories of the company.⁶⁹

8.2 Principles of Natural Justice

Sections 420 and 424 of the Companies Act, 2013 imbibe the principles of natural justice. Section 420 of the Companies Act, 2013 states,

“The Tribunal may, after giving the parties to any proceeding before it, a reasonable opportunity of being heard, pass such orders thereon as it thinks fit”

Further, Section 424(1) reads as:

“The Tribunal and the Appellate Tribunal shall not, while disposing of any proceeding before it or, as the case may be, an appeal before it, be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice, and, subject to the other provisions of this Act and of any rules made thereunder, the Tribunal and the Appellate Tribunal shall have power to regulate their own procedure.”

A close examination of Sections 420 and 424 reveals that while the procedural requirements outlined in the Code must be strictly adhered to, as mandated by Section 238 of the Code, the NCLT is bound by the provisions of the Act concerning its duties, obligations, and operational procedures.⁷⁰

The necessity of granting a fair opportunity to be heard has been extensively deliberated in numerous rulings issued by the NCLT/National Company Law Appellate Tribunal (NCLAT) within the framework of the Code, particularly in cases where the application submitted by a creditor to the debtor is not served.⁷¹

In the case of *Innoventive Industries Ltd. v. ICICI Bank and Anr.* (Order dated May 15, 2017), the NCLAT referenced several seminal judgments of the Supreme Court highlighting the significance of adhering to the principles of natural justice as an integral component of the "procedure established by law." The NCLAT underscored that the principles of natural justice are applicable in all instances unless expressly or implicitly excluded, as delineated in the judgment (Para 42), as provided below:

⁶⁹ Nimrit Kang & Nitin Nayar, 'The Evolution of Corporate Bankruptcy Law in India' ICRA Bulletin: Money and Finance, 37 (2003)

⁷⁰ Some Emerging Trends In The Evolution of Insolvency And Bankruptcy Code

⁷¹ The Bankruptcy Law Reforms Committee Report

“From the aforesaid decisions of Hon’ble Supreme Court, the exception on the Principle of Rules of natural justice can be summarised as follows:- (i) Exclusion in case of emergency, (ii) Express statutory exclusion, (iii) Where discloser would be prejudicial to public interests, (iv) Where prompt action is needed, (v) Where it is impracticable to hold hearing or appeal, (vi) Exclusion in case of purely administrative matters, (vii) Where no right of person is infringed, (viii) The procedural defect would have made no difference to the outcome, (ix) Exclusion on the ground of ‘no fault’ decision maker etc, (x) Where on the admitted or undisputed fact only one conclusion is possible- it will be useless formality.”

The NCLAT ruled that the NCLT, as the adjudicating entity, is obligated by section 420 of the Companies Act, 2013, which requires it to provide a fair chance to be heard. Additionally, the NCLAT⁷² emphasized that adherence to the principles of natural justice is compulsory for the adjudicating authority, as stipulated in section 424 of the Companies Act, 2013 (Para 49), as quoted below:

“As amended Section 424 of the Companies Act, 2013 is applicable to the proceeding under the I&B Code, 2016, it is mandatory for the adjudicating authority to follow the Principles of rules of natural justice while passing an order under I&B Code, 2016. Further, as Section 424 mandates the ‘Tribunal’ and Appellate Tribunal, to dispose of cases or appeal before it subject to other provisions of the Companies Act, 2013 or I&B Code 2016 such as, Section 420 of the Companies Act 2013 was applicable and to be followed by the Adjudicating Authority.”

In the mentioned case (Para 50), the NCLAT referenced a ruling from the Calcutta High Court regarding Sree Metaliks Limited & Anr. v. Union of India⁵ (April 7, 2017). The High Court determined that proceedings before the NCLT are adversarial in essence and entail significant consequences, thus individuals should not be condemned without being given an opportunity to be heard. It asserted that although the explicit application of principles of natural justice may not be stated, they can and must be implied.⁷³

“However, it is to apply the principles of natural justice in the proceedings before it. It can regulate its own procedure, however, subject to the other provisions of the Act of 2013 or the Insolvency and Bankruptcy Code of 2016 and any Rules made thereunder . . . Section 424 of the Companies Act, 2013 requires the NCLT and NCLAT to adhere to the principles of the natural justice above anything else. It also allows the NCLT and NCLAT the power to regulate their own procedure. Fetters

⁷² Ishan Bakshi, How the bankruptcy code is moving away from its promoter-averse approach, The Indian Express, (Apr. 16, 2021) <https://indianexpress.com/article/opinion/columns/insolvency-and-bankruptcy-code-amendments-modi-govt-7275456/> (last accessed on 16-02-2024)

⁷³ CRI Education Inc., Debtor in Possession (DIP), Corporate Finance Institute <https://corporatefinanceinstitute.com/resources/knowledge/credit/debtor-in-possession-dip/> (last accessed on 16-02-2024)

of the Code of Civil Procedure, 1908 does not bind it. However, it is required to apply its principles. Principles of natural justice require an authority to hear the other party . . . A person cannot be condemned unheard. Where a statute is silent on the right of hearing and it does not in express terms, oust the principles of natural justice, the same can and should be read into in.”

See also, Steel Konnect (India) Pvt. Ltd. v. M/s. Hero Fincorp Ltd. [Company Appeal (AT) (Insolvency) No. 51 of 2017]⁶ . The above views were reiterated and followed in subsequent rulings of NCLAT, viz. M/s. Starlog Enterprises Limited. v. ICICI Bank Limited [Company Appeal (AT) (Insolvency) No. 5 of 2017]⁷ , Kaliber Associates Pvt Ltd. v. Mrs Tripat Kaur [Company Appeal (AT)(Insolvency) No. 52 of 2017] to name a few.⁷⁴

Though the aforesaid rulings are in the context of the corporate debtor not being given an opportunity of being heard, the ratio may as well be applied to creditors who does not have a right to participate in the meetings of the creditors for consideration and approval of resolution plan. Applying the ratio, it is opined that the NCLT will have to afford the right to be heard, even though it is not provided for expressly in the Code, and failure of compliance with this will be a violation of principles of natural justice. In Daewoo Singapore Pte Ltd v CEL Tractors Pte Ltd. [2001] SGCA 53 (supra) too, the Singapore Court of Appeal stated:

“.....After a scheme is accepted by the creditors, an objecting creditor can persuade the court to withhold its approval, or to approve it subject to such alternatives or conditions as it thinks fit (see s 210(4)). The objecting creditor would succeed if he can show that the creditors did not vote bona fide for the benefit of the creditors or the company as a whole (see Re Wedgwood Coal and Iron Co (1877) 6 Ch D 627), or that the scheme is not fair and reasonable (see Re Dorman, Long & Co [1934] Ch 635... It is conceded, as of course it must be, that these principles do not apply where the obligation is extinguished by operation of law, as for instance in the case of bankruptcy or the winding up of a company, but it is submitted that the obligation in the present case is not extinguished by operation of law but rather is extinguished by the terms of the scheme which impose not only upon those creditors who assent to it, but upon all creditors, the effect of the document which constitutes the scheme.”

Recently, in Bhushan Steel insolvency case, the NCLT asked the committee of creditors of the corporate debtor to consider the objections raised by employees over the resolution plan submitted by Tata Steel⁷⁵

⁷⁴ Ibid

⁷⁵ Ibid.

8.3 Right of a party-in-interest to be heard: US Bankruptcy Code

Chapter 11 of the US Bankruptcy Code outlines the process of "reorganizing" debtors. According to Section 1109(b), any party with a vested interest, such as the debtor, trustee, creditors committee, equity securities holders committee, a creditor, an equity security holder, or an indentured trustee, has the right to raise issues and present arguments in a reorganization case.⁷⁶

8.4 Appeal against Unfair Prejudice: CVAs under UK Insolvency Act, 1986

Part 1 of the First Group of Parts of the Insolvency Act, 1986 (UK) enables the establishment of company voluntary arrangements (CVAs). Under this provision, the directors of a company (except those in administration or winding-up) can propose to the company and its creditors a composition to settle its debts or a scheme to manage its affairs.⁷⁷

According to Section 5, the approved CVA is binding on:

- (a) every person who was entitled to vote at that meeting (whether or not he was present or represented at it); or (b) every person who would have been so entitled if he had had notice of it, as if he were a party to the voluntary arrangement. Section 6 provides for challenge of decisions to be made by way of an application to the court, on the grounds (alternative/cumulative, as the case may be) that:
- a. The CVA unfairly prejudices the interests of a creditor, member or contributory of the company;
 - b. There has been some material irregularity at or in relation to either of the meetings. It must be noted that for the purpose of the meetings stipulated for approval of CVA, the UK Act read with relevant rules, makes no distinction amongst creditors. Similarly, section 262 of the UK Act provides for challenge of decisions taken in the meetings in respect of individual voluntary arrangements.

There have been several UK rulings on Section 262 of the UK Act, or analogous provisions pertaining to company voluntary arrangements, on the grounds on which a creditor may challenge the decisions taken at the creditors' meeting. Some crucial rulings on the point are *SISU Capital Fund Ltd v. Tucker* (2005) EWHC 2170; (2006) BCC 463, later followed in *Prudential Assurance Co Ltd v. PWG Powerhouse Ltd* (2007) EWHC 1002 (Ch); (2008) 1 BCLC 289; (2007) BCC 500. The grounds on which the decisions in a creditors' meeting may be challenged may be summed up as follows:⁷⁸

⁷⁶ Norton Rose Fulbright, *The UK Corporate Insolvency and Governance Act 2020: A move to a more debtor-friendly restructuring regime?* Norton Rose Fulbright (July 2020)

⁷⁷ Ibid.

⁷⁸ Ibid.

1. The issue whether a CVA unfairly prejudices the interests of a creditor under IA s.6 is to be judged on the information available at the time the CVA was approved.
2. (Any CVA (IVA) which leaves the relevant creditor in a less advantageous position than before the CVA- looking at both the present and the future – will be prejudicial. While every arrangement is a compromise, the issue is whether, with respect to the aggrieved creditor, it is unfair.
3. The onus is on the applicant to demonstrate that the voluntary arrangement which he challenges unfairly prejudices his interests. Usually, the unfairness being brought out is not in respect of creditors as a class, as the decision in the meeting already has a supermajority sanction, but the action is in the nature of a minority interest.
4. There is no single and universal test for judging unfairness in this context; determination of the existence of unfairness requires consideration of all of the circumstances including, as alternatives to the arrangement proposed (not only liquidation but a fairer scheme) and the practical consequences of a decision by the court to confirm or reject the arrangement.⁷⁹
5. Unfairness may be assessed by comparative analysis from a number of different angles including vertical comparison (i.e. with the position on winding-up or, in the case of individuals, bankruptcy) and horizontal comparison (with other creditors or classes of creditors).
6. In the context of horizontal comparison a useful guide (in the case of a CVA) is comparison with the position if, instead of a CVA, there had been a formal scheme of arrangement under the Companies Act, 2006 on which different classes of creditors would have been required to meet and vote separately.
7. As to vertical comparison with the outcome on a winding-up (or bankruptcy), a court is overwhelmingly likely to interfere with a CVA/IVA which would result in creditors or some of them receiving less than they would in a winding-up (bankruptcy), assuming the return by that process would in reality be achieved and within an acceptable timescale. Comparison with a winding-up or bankruptcy is not, however, always conclusive as to unfair prejudice.
8. Depending on the circumstances, differential treatment may be necessary to ensure fairness or to secure the continuation of the company's business which underlies the arrangement (e.g. where it is necessary to pay some suppliers in full).
9. It is not for the court to speculate whether the terms of a proposed CVA (IVA) which were put forward by an office-holder (resolution professional) were the best that could have been obtained, or whether it would have been better if it had not contained some of the terms which it did contain.⁸⁰

⁷⁹ James Watson, UK: Restructuring & Insolvency Comparative Guide, Mondaq, (Feb. 22, 2021) <https://www.mondaq.com/uk/insolvencybankruptcyre-structuring/939090/restructuring-insolvency-comparative-guide> (last accessed on 16-02-2024)

⁸⁰ Ibid.

10. Unless the court is satisfied that better terms or some other compromise would have been on offer, the comparison must be between the proposed compromise and no compromise at all judging matters as of the date of the vote on the CVA/IVA.
11. Because the statutory scheme envisages that different creditors might have different views on whether an arrangement should be approved and provides for the minority to be bound by the majority (subject to protection in cases of “unfair prejudice”), what the court is seeking to identify is disproportionate prejudice on one side or the other.
12. If a reasonable and honest man in the same position as the applicant might reasonably have approved the CVA/IVA under challenge, the challenge will in all probability fail but the fact that no reasonable and honest man in the same position as the applicant would have approved the CVA/IVA is not necessarily conclusive in favour of the applicant.

In *Jesner v. Jarrod Properties* [1992] BCC 807, it was held that prejudice and unfairness are two distinct requirements – a conduct that prejudices the petitioner may not be unfair. In *Rock Nominees Ltd v RCO (Holdings) Ltd* [2004] 1 BCLC 439 CA, the conduct under question was unfair but not prejudicial. Unfairness and prejudice shall be present simultaneously to be called “unfair prejudice”.

CHAPTER 9

CONCLUSION

The evolution of the Insolvency and Bankruptcy Code (IBC) in India marks a significant milestone in the country's legal and economic landscape. Enacted in 2016, the IBC was designed to overhaul the existing insolvency framework and provide a robust mechanism for resolving distressed assets efficiently and fairly. However, despite its noble objectives, the implementation of the IBC has been met with various challenges, particularly concerning the treatment of operational creditors compared to financial creditors.

To understand the current situation, it's essential to delve into the historical context of the IBC and its underlying purpose. Prior to the introduction of the IBC, India lacked a unified and time-bound insolvency resolution process, leading to inefficiencies and delays in resolving distressed assets. The IBC aimed to address these issues by providing a comprehensive legal framework that would streamline the insolvency resolution process, promote creditor rights, and facilitate the revival of viable businesses.

Despite its ambitious goals, the IBC has been criticized for primarily benefiting financial creditors at the expense of operational creditors. Financial creditors, typically banks and financial institutions, often hold secured debt and are prioritized in the insolvency resolution process, receiving preferential treatment over operational creditors, such as

suppliers and employees. This disparity in treatment has raised concerns about the fairness and equity of the IBC, as operational creditors are left with limited recourse and often receive minimal or no repayment for their dues.

The unequal treatment of operational creditors under the IBC has been a subject of debate and litigation, prompting calls for reform to ensure greater fairness and inclusivity in the insolvency resolution process. One of the key solutions proposed is the establishment of a pre-pack pool of independent professionals tasked with reviewing pre-packaged insolvency deals to ensure transparency and fairness, particularly in cases involving connected party transactions. This would help prevent instances of abuse and ensure that operational creditors are adequately represented and protected in the insolvency resolution process.

Another proposed solution is the voluntary appointment of an insolvency resolution professional (IRP) by the debtor to oversee the insolvency process and report any anticipated fraudulent conveyances to the pre-pack pool for review and approval. By empowering IRPs to act as watchdogs and guardians of creditor rights, the insolvency resolution process can be made more transparent, accountable, and equitable for all stakeholders, including operational creditors.

Furthermore, it's imperative to explore alternative models and best practices from jurisdictions like the United Kingdom and the United States, where insolvency laws prioritize the equitable treatment of all creditors and promote the rehabilitation of viable businesses. By adopting a holistic approach that balances the interests of financial and operational creditors, India can enhance the effectiveness and integrity of its insolvency framework and foster a more conducive environment for economic growth and investment.

While the IBC represents a significant step forward in India's insolvency regime, there is still much work to be done to address the disparities and shortcomings that exist, particularly concerning the treatment of operational creditors. By implementing targeted reforms and adopting best practices from international models, India can achieve a more equitable and inclusive insolvency resolution process that benefits all stakeholders and contributes to the country's economic development and prosperity.