

## **POSITION OF OPERATIONAL CREDITORS: IN REGARD TO CIRP AND LIQUIDATION**

*Written by Avinash Kumar*

*Student, LL.M. (Corporate and Commercial Laws), Chanakya National Law University,  
Patna, India*

DOI: [doi.org/10.55662/IJLDAI.2023.9202](https://doi.org/10.55662/IJLDAI.2023.9202)

### **ABSTRACT**

The Insolvency and Bankruptcy Code, 2016 became effective in May 2016 after receiving final presidential approval. The IBC is a complete code that acts as the focal point for all insolvency procedures. It was created to address the concerns about subpar loans that the Indian banking industry had. Previously, there was a lot of pending litigation regarding insolvency proceedings because of the protracted, years-long legislative process. But after the IBC was put into operation in 2016, the procedure has significantly improved in terms of both investor friendliness and cost-effectiveness. The regulation attempts to safeguard the interests of small investors by enabling recovery. The company must complete the insolvency procedure within 180 days of the process's beginning, and recovery proceedings under the IBC may be initiated by either the debtor or the creditor. Financial creditors and operational creditors are two separate types of creditors recognized by the IBC. Most of the company's creditors are simply under contractual or financial obligations to it, such as via loans or debt security. Among the operational creditors are the government, contractors, and employees. By designating them as Operational Creditors under IBC, the Insolvency and Bankruptcy Code, 2016, has worked to strengthen and advance the position of the Company's suppliers and service providers since its establishment. But unhappily, over time and as a consequence of multiple judgments, operational creditors' positions have become worse, especially in terms of their chances of receiving payment via the Corporate Insolvency Resolution Process. Several court decisions, committee recommendations, and legislative changes have all addressed the issue of giving operational creditors the same status as financial creditors. In this study, we will carefully examine the situations of operational creditors. The first part of the article will discuss who qualifies as an operational creditor. In the second segment, we'll

look at how operational creditors are affected by CIRP and liquidation. Thirdly, it will address various situations pertaining to the debate over whether operational creditors should be treated equally to financial creditors. Lastly, the paper figures out how operational creditors are treated under the IBC.

**Keywords:** Creditor, Insolvency, Resolution, Liquidation, Obligation.

## INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (herein referred to as IBC) was implemented by the Act of Parliament which got final presidential assent in May, 2016. The IBC is an Exhaustive Code in itself and is a one stop solution for all the Insolvency proceedings. It was introduced to address the bad loan concerns of the Indian banking system<sup>i</sup>. Earlier these Insolvency proceedings took long years to get resolved and there was a lot of pendency in cases due to the slow legislative procedure. However, with the enforcement of IBC, 2016 the procedure has become very investor friendly and economical too. The regulation strives to safeguard the interests of small investors by making the recovery process easier<sup>ii</sup>. Both the debtor and the creditor can initiate the recovery proceedings under IBC and the company has the obligation to complete the insolvency process within 180 days from initiation.

There are two kinds of creditors provided under IBC, one is financial creditor and the other is an operational creditor. If we go by the definition provided under section 5(7)<sup>iii</sup> IBC, a Financial Creditor is defined as:

*“Means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to.”*

Majorly financial creditors are those whose relationship with the company is pure financial and contractual in nature such as a loan or debt security.

Whereas, section 5(20)<sup>iv</sup> defines Operational Creditors as follows:

*“Means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred”.*

Operational creditor is basically a person or a company that provides either goods or services to the company on credit and thus becomes the debtor of the company<sup>v</sup>. Vendors and suppliers, employees or Government are good examples of Operational Creditors.

The Insolvency and Bankruptcy Code, 2016 since its beginning has always tried to strengthen and empower the position of the suppliers and service providers of the Company by granting them the designation of Operational Creditors under IBC. But unfortunately, with the passage of time and with the passing of several judgments the position of Operational Creditors has weakened with the time, especially with regard to chances of realization during the Corporate Insolvency Resolution Process (herein referred to as CIRP). There have been many judicial pronouncements, committee reports and legislative amendments<sup>vi</sup> which revolve around giving an equal status to operational creditors as that of financial creditors. In the famous case of Swiss Ribbons, the Supreme court clearly stated that “Operational creditors are seldom interested in the financial health of the company and consequently, cannot be allowed to determine the fate of a company.”

In this Research paper we will analyse the position of Operational creditors in a systematic manner. The first part of the paper will deal with who is an Operational Creditor. The second part will look into the position of operational creditors with regard to CIRP and Liquidation. Thirdly it will cover a catena of cases on the issue that should Operational creditors be treated at par with financial creditors. And finally reaching to a conclusion that what status do operational creditors enjoy under IBC.

## **WHO IS AN OPERATIONAL CREDITOR?**

Section 5(20)<sup>vii</sup> defines Operational Creditors as follows:

*“Means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred”.*

Operational creditor is basically a person or a company that provides either goods or services to the company on credit and thus becomes the debtor of the company. Vendors and suppliers, employees or Government are good examples of Operational Creditors. Here the term ‘legally assigned or transferred’ means for example Reliance is the actual operational creditor of

company X and company X purchased goods from reliance worth Rs. 10 Crores. Now reliance feels that it doesn't want to get involved for such a small amount and thus it further appoints Wipro as its legal assignee/transferee and assigns the credit to it. Now Wipro becomes the actual Operational creditor and will have all the rights and liabilities same as reliance.

Similarly, the term Creditor has also been defined under sec. 2(10)<sup>viii</sup> IBC as:

*“Any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor and a decree holder.”*

The scope of the term creditor has been much widened under IBC and includes all kinds of creditors of the company. The term Creditor was first introduced in The Companies Act, 2013 but the act failed to give any proper definition to the term<sup>ix</sup>. Thus, for the sake of clarification the IBC, 2016 has classified creditors into two categories: Financial creditors and Operational creditors. IBC comes into picture when a corporate debtor fails to make payment to its creditors or lenders in due time then they can initiate insolvency proceedings under this code. Section 6 of IBC prescribes that who all can initiate Insolvency proceedings under the act in case of default.

1. **Financial Creditors:** here it refers to a bank or any financial institution that has granted a credit facility or a loan of any kind.
2. **Operational Creditor:** it refers to any person who provides products or services to companies for which the corporate debtor is owed payment.
3. **Corporate Debtor:** a corporate debtor is a person who owes a debt to another person.

## **POSITION OF OPERATIONAL CREDITORS**

### **1) The Committee Reports:**

1. The Bankruptcy Law Committee Report, 2015- The BLRC Report, 2015 felt the need for the protection of the operational creditors and thus proposed that the final resolution plan as approved by CoC must protect the rights of the operational creditors and also, they must be guaranteed a fair payback of their dues. The BLRC focussed on the need of giving right of fair payback to the operational creditors through effective resolution plans<sup>x</sup>, as this can be the

only effective resolution of their debts, else, there will be no effective resolution to the default payments of the corporate debtor and thus it may lead to more defaults in future. However, the BLRC failed to provide such position to the operational creditors and the position they were enjoying was further weakened by the Insolvency Committee Report, 2018.

2. The Insolvency Committee Report, 2018- ICR, 2018 claimed that the operational creditors fall under the residual category as specified under S. 53, IBC as their recovery valuation at the finalization of resolution plan is almost negligible<sup>xi</sup>. Thus, following this claim of the ICR, the Supreme court in a recent case<sup>xii</sup> upheld a resolution plan passed by CoC, which provided that NIL amount is due to the operational creditor. Therefore, the ICR, 2018 has harshly affected the position of the operational creditors under IBC.

3. The Insolvency Committee Report, 2020- ICR, 2020 turns out to be in favour of the operational creditors as it recommends that the operational creditors should be allowed to vote in the CoC. Basically, the report suggests that the operational creditors should also have some say in the CoC. Therefore, just like financial creditors the operational creditors must also enjoy equal voting rights. On the contrary, the ICR, 2020 after making all the recommendations noted that the IBC, 2016 with all its provisions and amendments has proved to be a bane for the operational creditors as it provides them with an opportunity to take the corporate debtor to court for the settlement, which seems very contradictory as per the recent IBC amendments which have watered down the position of operational creditors.

➤ Amendment of 24<sup>th</sup> March, 2020: This Amendment has brought about major changes in the position of operational creditors and also jeopardized their bargaining power by raising the threshold limit for initiation of CIRP from Rs. 1 lac to Rs. 1 crore, which is a very major jump. The operational creditors usually have a very small amount for recovery as compared to that of financial creditors. But at least they had the privilege of initiating CIRP in case of default against the corporate debtor, unfortunately after this amendment the operational creditors who have debts less than Rs. 1 crore are left with no remedy. With the enforcement of this amendment the position of operational creditors has worsened. Also, the financial creditors have the option of filing a joint application for initiating a CIRP, but the operational creditors are not even conferred with such right. Thus, if any of the operational creditor fails

to achieve threshold limit of 1 crore, then he has no remedy under IBC other than approaching the courts for justice.

## 2) **Corporate Insolvency Resolution Proceedings (CIRP):**

CIRP is known to be the recovery mechanism<sup>xiii</sup> initiated in case of a default of dues owed to creditors by the corporate debtor. The IBC lays down the procedure as per which the CIRP has to be conducted in case of any default. The Operational debtors are given the right under IBC to initiate recovery mechanism (insolvency proceedings) against the corporate debtor. Earlier the CIRP proceedings could be initiated against the corporate debtor in case of default of minimum Rs. 1 lac. But, as per the latest amendment made on 23<sup>rd</sup> March, 2020<sup>xiv</sup> this limit has been raised to Rs. 1 Crore.

### ***Procedure of initiating CIRP proceedings:***

1. **Filing Of Application Under Section 8 & 9-** as per the requirements of S. 8(1)<sup>xv</sup>, on the occurrence of a default, an operational creditor may issue a demand notice of the unpaid amount with an attached copy of invoice seeking the payment of the default amount as prescribed under Sec. 8, IBC.

Furthermore, S. 9(1)<sup>xvi</sup> of the act proves that if the operational creditor does not receive payment from the corporate debtor or the notice regarding the dispute under S. 8(2)<sup>xvii</sup> within ten days of the date of delivery of the notice or invoice demanding payment under sub-section (1) of section 8, the operational creditor has all the rights to file an application with the Adjudicating Authority to initiate a corporate insolvency resolution process against the defaulter corporate debtor<sup>xviii</sup>.

Once the application filed by the operational creditor gets accepted by the adjudicatory authority, then as per S. 10<sup>xix</sup> the authority should initiate CIRP against such debtor. The CIRP must be in all cases completed within 180 days from the date on which the application was admitted, without any unnecessary delays. In case the adjudicatory authority finds it necessary in the interest of justice, may extend this but not for more than 90 days.

Certain conditions have been specified under IBC for invoking CIRP against the corporate debtor, these include<sup>xx</sup>:

a) The amount of default should not be less than Rs. 1 crore (as per latest amendment released on 23<sup>rd</sup> March, 2020),

- b) The last unpaid invoice should not be dated more than 3 years back,
- c) The unpaid invoice(s) must not be disputed, before sending the demand notice.

2. Sec. 16- Appointment of Insolvency Resolution Professional: Upon the commencement of CIRP after admission of application filed under section 8 & 9 of IBC by the operational creditor, it is the duty of the adjudicating authority to appoint an interim resolution professional with a time period of fourteen days<sup>xxi</sup>. Once the resolution professional gets appointed, he fulfils certain duties that includes- sending summons, verification of claims and listing them.

Sec. 16(3)<sup>xxii</sup> states that, if an operational creditor files a request for a corporate insolvency resolution and also makes a proposal under sec. 9(4) for an interim resolution professional of his choice to be appointed to his case. Such proposal shall be accepted by the adjudicatory authority subject to the condition that no disciplinary proceedings should be pending against desired professional.

3. Composition Of Committee of Creditors (Coc)- S. 21(1) states the after the collating the claims received, the interim resolution professional shall constitute a Committee of Creditors (herein referred to as CoC). The CoC usually comprises of all the financial creditors of the company. Unfortunately, the operational creditors are not given equitable position in the CoC and they can just move an application for initiation of the CIRP proceedings. Once the CIRP proceedings begin and the CoC is formed, only the financial creditors have the power to be a part of such committee. This issue was raised and challenged before the Calcutta High court in the case “*Akshay Jhunjunwala v. Union of India*”<sup>xxiii</sup>, where the Petitioner had challenged Sec. 7, 8 and 9 of IBC as unconstitutional on the ground that it makes an unnecessary distinction between financial creditors and operational creditors, and hence must be struck down with immediate effect. The petitioner also contended that the operational creditors are also not given the right to be a part of CoC, such right is only enjoyed by the financial creditors<sup>xxiv</sup>. The Calcutta High court dismissed the petition filed by the petitioner and held that the “Classification amongst similarly situated persons is permissible if the classification is based on reasonable differentia.” Similarly in the case of “*Swiss Ribbons Pvt. Ltd. V. Union of India*”<sup>xxv</sup> the supreme court also opined the same and held the distinction made under IBC between financial creditors and operational creditors to be reasonable and valid, hence constitutional.

From the above passage it becomes utter clear that the operational creditors cannot be the part of CoC. However, section 24(3)(c), IBC states that it is the duty of the resolution professional to serve notice of CoC to the operational creditors only in case if their aggregate dues amount to not less than 10% of the debt<sup>xxvi</sup>. If the prior condition is fulfilled then the operational creditors may choose any one representative on their behalf who will be allowed to attend CoC but will not have the right to vote. The representative can just attend the meeting, give his feedback but it is the financial creditors who finally take the decisions at the end.

### **3. When An Operational Creditor Can Be A Part Of Coc:**

Many times, there arises a situation in which there are no financial creditors to the corporate debtor in the CIRP process and it only consists of operational creditors, in such a situation the CoC shall consist of such members as specified by the Insolvency and Bankruptcy Board of India (IBBI).

The provision for the same has been provided under Regulation 16(2) of “IBBI (INSOLVENCY RESOLUTION PROCESS FOR CORPORATE PERSONS) REGULATIONS, 2016”, which states that in case there are only operational creditors in the CIRP process then the CoC shall comprise of<sup>xxvii</sup>:

- a) Eighteen operational creditors with the max claim value,
- b) One representative who is elected by the workmen on behalf of them all, and
- c) One representative who is elected by all the employees to represent them in CoC.

The regulation further stipulates that the member appointed under this will also have the voting rights as per their proportion of the debt due.

The IBC explicitly and intentionally excludes the operational creditors from being a part of the CoC, and only the financial creditors are given the power to take major decisions in CoC, which may or may not be in the favour of operational creditors. It is worth noting that IBC doesn't specifically provide for the min. number of financial creditors required to set up a CoC. Rather it states that the CoC can be constituted by all financial creditors and no operational creditors, which eventually means that even if one financial creditor is there then a CoC can be setup and thus final resolution will be the decision of that financial creditor who will decide the fate of corporate debtor. As per this scenario, the only situation in which the operational creditors can get the right of voting is if there are no financial creditors<sup>xxviii</sup>. This



whole situation of operational creditors under IBC is very much against the objective of IBC, “balancing the interests of all shareholders”.

#### **4. Can An Advocate Issue A Demand Notice On Behalf Of Operational Creditor?**

This issue has been dealt with in the case of “*Macquaire Bank Ltd. V. Shilpi Cable Technologies Ltd.*”<sup>xxix</sup>, here the issue was that the demand notice was served to the corporate debtor by the advocate hired by the operational creditor. So, the corporate debtor raised issue against that demand notice being served by an advocate is not permitted (specified) under S. 8, IBC and it can only be issued by the operational creditor himself or by any of his authorized agent. The Supreme court finally concluded that demand notice can be issued by an advocate irrespective of the fact whether it is specified under S. 8 or not and hence rejected the plea of corporate debtor.

#### **5. Right To Appeal To Resolution Plan Passed By Coc:**

The CoC after the final decision taken by the financial creditors pass a resolution plan which is further communicated to the operational creditors. In case the operational creditor(s) are not satisfied with the decision plan of the CoC, then within 30 days of passing of such resolution plan the operational creditor(s) can file an appeal<sup>xxx</sup> in NCLT.

S. 61(3) provides for the grounds and form for filing appeal in NCLT. The appeal may be filed on the following grounds:

- a) That the approved resolution plan is in contravention of the provisions of any law for the time being in force;”
- b) That there has been material irregularity in exercise of the powers by the resolution professional during the corporate insolvency resolution period;”
- c) That the debts owed to operational creditors of the corporate debtor have not been provided for in the resolution plan in the manner specified by the Board;”
- d) That the insolvency resolution process costs have not been provided for repayment in priority to all other debts;” or
- e) That the resolution plan does not comply with any other criteria specified by the Board.”

## LIQUIDATION: ASSET DISTRIBUTION

It becomes utterly clear that how the operational creditors are treated differently and in a very biased manner under IBC, 2016, be it regarding the initiation of CIRP or major committee recommendations or in the cases of Liquidation and distribution of assets. Similarly, the resolution amount which has been decided by the CoC is also distributed in such a manner jeopardizing the interests of operational creditors<sup>xxxii</sup>. The financial creditors have been given an upper hand under IBC in almost all situations. Regarding the distribution of resolution proceeds following provision has been made under S. 30<sup>xxxii</sup>, IBC- provision reads as follows:

“(1) A resolution applicant may submit a resolution plan to the resolution professional prepared on the basis of the information memorandum.

(2) The resolution professional shall examine each resolution plan received by him to confirm that each resolution plan—

(a) provides for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the payment of other debts of the corporate debtor;

(b) provides for the payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than-

(i) the amount to be paid to such creditors in the event of a liquidation of the corporate debtor under section 53; or

(ii) the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of section 53,

whichever is higher, and provides for the payment of debts of financial creditors, who do not vote in favour of the resolution plan, in such manner as may be specified by the Board, which shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) of section 53 in the event of a liquidation of the corporate debtor.”

From the plain reading of the text itself it becomes clear that S.30(2)(b)<sup>xxxiii</sup> (i) and (ii), provide for differential treatment of the operational creditors. In the famous case of “*Binani Industries*

*Ltd. V. Bank of Baroda*<sup>xxxiv</sup> the NCLT observed that, the biased treatment regarding distribution of assets as provided under Section 30(2)(b) will lead to such a situation in future where no operational creditors will be willing to supply goods or services to the corporate debtors or else will start dealing on pre-payment basis which will eventually disrupt the economy. Hence, the operational creditors must be treated at par with financial creditors in terms of 'Resolution Plan' and any such plan which goes against the interests of operational creditors will be treated as invalid and against the provisions of IBC<sup>xxxv</sup>.

This issue of unequal treatment has been further dealt in the case of "*Essar Steel India Ltd. V. Satish Kumar Gupta*"<sup>xxxvi</sup> wherein the Supreme court has outrightly rejected the contention that the operational creditors should be treated equal to financial creditors, rather the Supreme court said that such treatment must be equitable but not equal. "However further question remains whether the Court has jurisdiction like an appellate authority to minutely scrutinise the scheme and to arrive at an independent conclusion whether the scheme should be permitted to go through or not when the majority of the creditors or members or their respective classes have approved the scheme as required by Section 391(2). On this aspect the nature of compromise or arrangement between the company and the creditors and members has to be kept in view. It is the commercial wisdom of the parties to the scheme who have taken an informed decision about the usefulness and propriety of the scheme by supporting it by the requisite majority vote that has to be kept in view by the Court. The Court certainly would not act as a court of appeal and sit in judgment over the informed view of the parties concerned to the compromise as the same would be in the realm of corporate and commercial wisdom of the parties concerned. The Court has neither the expertise nor the jurisdiction to delve deep into the commercial wisdom exercised by the creditors and members of the company who have ratified the Scheme by the requisite majority. Consequently, the Company Court's jurisdiction to that extent is peripheral and supervisory and not appellate. The Court acts like an umpire in a game of cricket who has to see that both the teams play their game according to the Rules and do not overstep the limits. But subject to that how best the game is to be played is left to the players and not to the umpire."

Further, section 53<sup>xxxvii</sup> provides for the manner in which the assets will be distributed in case of liquidation of the corporate debtor. This process is also known as the waterfall mechanism. It has been noticed that operational creditors, who are workers, would be given first preference for the clearance of their debts for a timeframe of 24 months previous to the date on which

the liquidation's start, together with clearance of secured creditors' debts. Financial Creditors, such as Banks and Other Financial institutions, are often seen as Secured Creditors. However, it is possible, though unlikely, that operational creditors be also treated as secured creditors, and in such case, these secured operational creditors would receive preference over other creditors. Wages and any outstanding dues owing to workers many of whom are Operational Creditors, other than the labourers mentioned above, have precedence in respect of the dues for the 12 months before the liquidation process initiation date<sup>xxxviii</sup>. Dues owed to the state and federal governments are also operational, and they supersede after those owed to unsecured financial creditors. In some situation, if the Operational Creditors are seen as secured creditors, then they may request payment of the remaining balance once the security interest has been enforced. In this waterfall system, individuals who owe money to workers and employees for more than 24 months, as well as those who have delivered items, are at the bottom.

The liquidator is officially assigned with the duty of assessment of claims. And, if the operational creditor is dissatisfied with the Liquidator's assessment of claims, he has the right to appeal such order to the Adjudicating Authority within 14 days<sup>xxxix</sup>, as provided by S. 42<sup>xl</sup>, IBC. Furthermore, if a case of devalued transactions arises and the liquidator fails in his duty to notify the same to the adjudicating authorities, the operational creditor has the right do so and reverse such devalued transactions that were performed incorrectly or erroneously.

## **SHOULD OPERATIONAL CREDITORS AND FINANCIAL CREDITORS BE TREATED EQUALLY?**

The question of equal rights of distribution for operational creditors has been heard by the judiciary in numerous cases such as “*Akshay Jhunjunwala & Anr. v. Union of India through the Ministry of Corporate Affairs & Ors.*” and “*Shivam Water Treaters Private Limited v. Union of India & Ors.*”, where the Apex Court restricted the High Courts from entering the debate. In 2018, in the case of “*Rajputana Properties Pvt. Ltd. v Ultratech Cement Ltd. & Ors.*”, the Supreme Court held that the dues owed to the operational creditor should be treated similarly to the dues of the financial creditor. It can be inferred from the decision of the court that the treatment may be different but it cannot be discriminatory in nature<sup>xli</sup>. However, after the saga of the Essar steel case and the 2020 amendment to the IBC, the issue has essentially

come to a standstill. The Bankruptcy Law Review Committee stated in its report released on Nov. 4, 2015 that, “Operational creditors will not risk their dues in exchange for the corporate debtor's potentially bright future, and that the CoC should only consist of financial creditors to carry out the insolvency resolution process more effectively.” This statement very much against the interests of operational creditors and thus puts them into a weak position as compared to financial creditors<sup>xlii</sup>. The assumption behind this position was that operational creditors would be more interested in the corporate debtor's liquidation than the firm's resuscitation, which would ultimately contradict the IBC's core aim. Based only on such false assumption the operational creditors have been given much lesser rights as compared to that of financial creditors. The operational creditors enjoy much better treatment in other countries such as U.S. and U.K., where they are treated at par with secured creditors. Therefore, the provision of not providing operational creditors with basic rights such as- right to be a part of CoC or having the right to vote is not just against the agenda of IBC but is also very unlawful and irrational.

### **CATENA OF CASES REVOLVING AROUND THIS ISSUE**

A significant number of judicial rulings regarding the status of operational creditors have recently been passed, deciding the fate of operational creditors. The Supreme Court has decided that financial creditors are probably more suited to determine the destiny of a corporate debtor, starting with *Swiss Ribbons v. Union of India* and concluding with *Essar Steel India Limited* case. As a result, not only the destiny of the corporate debtor, but also the destiny of the operational creditor, has been entrusted to the "commercial wisdom" of the CoC, which is technically controlled by the choices of Financial Creditors.

In “*Swiss Ribbons V. Union of India*”<sup>xliii</sup>, the Supreme Court expressly evaluated whether the operational creditors' lack of representation on the CoC constituted a violation of Article 14 of the Constitution. The Supreme Court based its decision on the basis for excluding operational creditors from the CoC, which was based on the Bankruptcy Law Reforms Committee's report, which is the antecedent to IBC. Financial creditors, according to the BLRC, could assess the viability of a resolution plan since they had educated workers to do so. Operational creditors, on the other hand, are solely interested in retrieving the money they owe for their goods and services and are thus are often unable to judge a company's

profitability and feasibility. The Supreme court also held the distinction made under IBC between financial creditors and operational creditors is reasonable and valid, hence constitutional and not violative of Article 14.

In “*Maharashtra Seamless Limited v. Padmanabhan Venkatesh*”<sup>xliv</sup>, The Supreme Court, keeping in mind the primacy given to the CoC, concluded that as far as the CoC accepts the resolution plan, it does not have to meet the valuation. The priority granted to financial creditors would only have negative effects upon other competitive creditors and the corporate debtor, since the financial creditors' primary aim will be to maximise their own worth.

In “*Binani Industries V. State Bank of India*”<sup>xlv</sup>, The Hon'ble NCLAT's remarks and observations in this case are noteworthy. When interpreting Section 30(2)(b), IBC, the NCLAT stated that giving operational creditors just the liquidation value based on a misinterpretation of Section 30(2)(b) will further hinder the creditors from continuing to deliver goods and services to the corporate debtor on credit facility. This would force suppliers of products and services to demand advance payments, which would be antithetical to grundnorm of IBC. The NCLT believed that the operational creditors will start dealing on pre-payment basis which will eventually disrupt the economy. Hence, the operational creditors must be treated at par with financial creditors in terms of ‘Resolution Plan’ and any such plan which goes against the interests of operational creditors will be treated as invalid and against the provisions of IBC.

In “*Hammond Power Solutions Private Limited V. Sanjit Kumar and Ors*”<sup>xlvi</sup>, Following the Supreme Court's ruling in *Essar Steel*, the NCLAT determined that it was critical for the resolution applicant to explain how all stakeholders' interests are protected. This trend offers a ray of light since it may be difficult for the resolution applicant to justify making no payment to operating creditors.

Finally, in the “*Essar Steel India Limited through Authorized Signatory V. Satish Kumar Gupta*”<sup>xlvii</sup> *Essar Steel* filed a Company Petition before the Ahmadabad NCLT, where Arcelor Mittal proposed such a resolution plan which was already adopted by the Resolution professional and the CoC. As per the agreed plan, the operational creditors were promised to be paid 8% of their entire claim under this scheme. Financial creditors, on the other hand, received 92.5 percent of their entire claims. The operational creditors filed a series of petitions challenging the settlement. The NCLAT then reallocated the plan's receivable claims

*and issued a ruling that marks a turning point in the debate over whether operational creditors must be treated equally to their financial counterparts.*

NCLAT held that because the financial creditors were participants of the CoC but the operational creditors were not, it was determined that the financial creditors already had the authority to adopt their resolution plan. As a result, the tribunal took away the CoC's ability to pick the distribution. It was determined this way because otherwise there would be a conflict of interest, with the company having the upper hand in deciding on a distribution that favoured them. The same was challenged by the CoC in the Supreme court and the Supreme court reversed the judgement of NCLAT and held that<sup>xlviii</sup>:

- The Supreme court overturned the judgement in the favour of the CoC, as it believed that CoC had the right understanding of the Resolution plan,
- The NCLAT through its judgement wanted to treat the operational creditors at par with the financial creditors, but Supreme court did not support this view and held that the treatment can be equitable but not equal;
- The Court upheld the preference given to the financial creditors and the Resolution plan passed by them, as the fate of the company lies in their hands and therefore, they hold a primary position in the company. They very well know the viability and future prospects of the company.
- The Operational creditors can be a part of CoC only in case if their aggregate dues amount to not less than 10% of the total debt. The Operational creditors were only given the right to be a part of CoC and still don't have the right to vote in CoC.

## **CONCLUSION**

From Swiss Ribbons to the Essar Steel India Committee of Creditors case, the Supreme Court has decided that financial creditors are better suited to judge a corporate debtor's destiny. As a result, not only the fate of the corporate debtor, but also the fate of the operational creditor, has been entrusted to the CoC's "commercial acumen" (where the Financial Creditor controls the choices). It's worth noting that the Insolvency Committee's latest Report, 2020, proposed that operational creditors be given voting rights in the future. And once the voting rights will be given to operational creditors then they will be in the better position under IBC. It clearly states that voting rights may be granted to operational creditors based on institutional

characteristics and if they are capable of making critical choices to resolve insolvency. When and how this will be accomplished remains to be seen. Financial creditors are given priority over operational creditors even during liquidation and asset distribution. As a result, the IBC restricts an operational creditor's rights to merely attending the CoC meeting. As a result, they are unable to participate in the decision-making process. The IBC's self-proclaimed goal is to "maximise the value of the corporate debtor's assets" and "balance the interests of all stakeholders." In this context, the complete disenfranchisement and disrespect for the operational creditors' interests look unreasonable. Unfortunately, rather than examining ways to ensure that operational creditors are treated fairly, the Parliament has attempted to further restrict their rights. This was accomplished by inserting a statement that distribution in line with IBC Section 30(2)(b) would be considered "fair and equitable." This clause is clearly designed to exclude any objection to the resolution plan's planned handling of operational creditors' dues. The Indian Parliament's haste in overturning the NCLAT ruling in Essar Steel and further disempowering operational creditors appears to be another example of knee-jerk reactions rather than well-reasoned stances.



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