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A Doctrinal Analysis of Implications of Differential Treatment under IBC, 2016, on Operational Creditors, Impact on MSMEs and Addressing the Question of Fairness

ADITYA VINAYAK NISAL¹

ABSTRACT

The Insolvency and Bankruptcy Code, 2016 (IBC) has bifurcated the creditors to whom debts are due into two categories: Financial Creditors (FCs) and Operational Creditors (OCs). During the Corporate Insolvency Resolution Process (CIRP) and recovery of dues during liquidation, FCs have been given preferential treatment, while OCs, which consist of suppliers, service providers, employees and government bodies, face a lengthy, time-consuming insolvency initiation process, are kept out of participation in CIRP and have been included in the category of unsecured debtors who are in the lowest rank for repayment of dues by distribution of assets under Section 53. The Courts, through various judgements, have justified such differential treatment of OCs, citing the commercial wisdom of the FCs and fairness. These circumstances have negatively affected MSMEs and small businesses engaged in the supply of goods and services to corporate debtors (CDs) on credit. Through this research paper, we shall analyse the legal framework governing OCs under IBC, analyse landmark judgments propounded by the judicial authorities, scrutinise whether OCs are dealt with procedural and substantive fairness, explore how such substituted status affects MSMEs and finally, undertake a comparative analysis with the U.S. Bankruptcy Code to identify best practices. The paper concludes by recommending reforms to strengthen OC rights, restore balance between classes of creditors and ease the position of MSMEs.

Keywords: *Corporate Insolvency Resolution Process (CIRP), Operational Creditors (OC), Financial Creditors (FC), Insolvency and Bankruptcy Code, 2016 (IBC), MSME.*

I. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC)², is considered to be the pillar of insolvency law, which regulates the corporate insolvency process in India³. Pre-IBC framework and

¹ Author is a Student at School of Law, MIT World Peace University, Pune, Maharashtra, India.

² The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Acts of Parliament, 2016 (India).

³ C. V. Gouri, Corporate Insolvency Resolution Process: An Overview of the Procedural Regime and its Economic

provisions dealing with insolvency and bankruptcy were enacted in various laws, such as the Sick Industrial Companies Act 1985⁴, the Recovery of Debt Due To Banks and Financial Institutions Act 1993⁵, the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act 2002⁶ and the Companies Act 2013⁷ which in turn established various forums such as Board of Industrial and Financial Reconstruction (BIFR), Debt Recovery Tribunal (DRT) and National Company Law Tribunal (NCLT) and its respective Appellate Tribunals. Even the liquidation of the companies was separately handled by the high courts, and the individual insolvency was dealt with by various legislations, such as the Presidential Towns Insolvency Act, 1909⁸ and Provincial Insolvency Act, 1920⁹, which was ultimately dealt with by the Courts. Such a framework resulted in undue delays in resolution and turned out to be effective and inefficient, which led to the enactment of the IBC¹⁰.

Various committees made recommendations for a consolidated law, but most notable was that of the Bankruptcy Law Reform Committee (BLRC), established in 2014, which recommended a creditor-driven framework in a time-bound resolution process, to maximise asset value, improve the business environment and encourage entrepreneurship. This inspired the enactment of the IBC, which consolidates regulations related to insolvency proceedings for companies, firms, and individuals, replacing all other legislation¹¹.

The Code has distinguished creditors into FCs and OCs. The person to whom financial debt is owed or to whom such debt is legally assigned is termed FC¹². Financial debt refers to a debt that is distributed considering the time value of money and includes funds borrowed against payment of interest, amount raised by issuing bonds, debentures or similar instruments or money raised through any other method as mentioned in the Code¹³. Such creditors are part of CoC and have the right to participate and vote in the meetings of the Committee¹⁴. On the other

Relevance, 7(2) *Int'l J. Legal Sci. & Innovation* 734 (2025).

⁴ The Sick Industrial Companies (Special Provisions) Act, 1985, No. 1 of 1986, Acts of Parliament, 1985 (India)

⁵ The Recovery of Debts Due to Banks and Financial Institutions Act, 1993, No. 51 of 1993, Acts of Parliament, 1993 (India).

⁶ The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, No. 54 of 2002, Acts of Parliament, 2002 (India).

⁷ The Companies Act, 2013, No. 18 of 2013, Acts of Parliament, 2013 (India).

⁸ The Presidency Towns Insolvency Act, 1909, No. 3 of 1909, Acts of the Governor-General of India in Council, 1909 (India).

⁹ The Provincial Insolvency Act, 1920, No. 5 of 1920, Acts of the Indian Legislature, 1920 (India).

¹⁰ Malik Zain Ul Abudin & Ajaz Afzal Lone, Evolution of Insolvency and Bankruptcy Code in India, 7(6) *Int'l J. L. Mgmt. & Human.* 371 (2024).

¹¹ Malik Zain Ul Abudin & Ajaz Afzal Lone, Evolution of Insolvency and Bankruptcy Code in India, 7(6) *Int'l J. L. Mgmt. & Human.* 371 (2024).

¹² Insolvency and Bankruptcy Code, 2016, § 5(7), No. 31 of 2016, Acts of Parliament, 2016 (India).

¹³ Insolvency and Bankruptcy Code, 2016, § 5(8), No. 31 of 2016, Acts of Parliament, 2016 (India).

¹⁴ Insolvency and Bankruptcy Code, 2016, § 21, No. 31 of 2016, Acts of Parliament, 2016 (India).

hand, OCs are referred to as the persons to whom operational debt is owed¹⁵. Operational debt is said to be claims related to the provision of goods or services, employment dues or any dues payable to the government¹⁶.

The difference in the treatment of classes of creditors is such that during the CIRP, the OCs cannot play an active role in the decision-making process, as the CoC, which decides on the insolvency process, is composed mainly of FCs. OCs are included in the CoC only if they satisfy a prescribed threshold, and even in such rare cases, OCs do not have voting rights in the committee¹⁷. Additionally, the CIRP initiation process is different for each creditor. FCs have to follow a relatively simple process enshrined in Section 7, rather than that of OCs, who are required to follow a lengthy procedure provided under Sections 8 and 9, wherein the OC first has to send a demand notice to the CD. If the matter is not resolved within the specified time, only the OC can initiate CIRP. In case of any pending dispute related to such debt, the claim of debt is rejected by the Adjudicating Authority, and such OC cannot initiate CIRP. Even under the order of distribution of assets during liquidation, under Section 53¹⁸, the category of debts owed to unsecured creditors is preceded by debts owed to the government, and there is no specific mention of the OCs. This provision, therefore, preferentially allows satisfaction of debts of FCs, leaving OCs to fall under the category of “remaining and debts due”, which is the last category in the list of distribution of assets, above equity shareholders.

From the above scenario, it is clear that the Code has preferred FCs over OCs. The FCs are in a dominant position in every aspect of insolvency proceedings, such as position in the CoC, voting rights and decision-making powers. Their decisions are binding upon every stakeholder involved in the insolvency proceedings. The OCs, on the other hand, have not been provided with many rights in the Code and have no representation in the CoC, thereby making OCs vulnerable to the wishes of the FCs, with no guarantee that the maximum amount of debt would be recovered, as they fall in the last position under the list of distribution of assets under Section 53. To complicate matters further, the Court, in certain cases discussed hereinafter, upheld the dominance of FCs in the insolvency process, citing commercial wisdom and has held that the distinction between the creditors passes the test of equality under Article 14 of the Constitution, further marginalising OCs.

Such conditions in the insolvency resolution process and approach of the Court do not

¹⁵ Insolvency and Bankruptcy Code, 2016, § 5(20), No. 31 of 2016, Acts of Parliament, 2016 (India).

¹⁶ Insolvency and Bankruptcy Code, 2016, § 5(21), No. 31 of 2016, Acts of Parliament, 2016 (India).

¹⁷ Priya Kumari, Operational Creditors Under the IBC: Unequal Footing or Justified Differentiation? 7(3) Int'l J. Multidisciplinary Rsch. (2025)

¹⁸ Insolvency and Bankruptcy Code, 2016, § 53, No. 31 of 2016, Acts of Parliament, 2016 (India).

adequately acknowledge the significance of the supply of goods and services, creating insecurity among OCs entering into new transactions¹⁹. OCs provide the working capital required for the daily functioning of the business, without which, the business will struggle to stay afloat. Additionally, MSMEs and small businesses supplying goods and services to the CD are categorised as OCs. The Code has not differentiated between MSMEs and small businesses from other businesses. This issue becomes complicated when OCs are guaranteed liquidation value; however, in practice, such an amount is rarely recovered by OCs, which is one of many reasons MSMEs and other OCs suffer under the IBC²⁰. Neglecting such a category of creditors will defeat the very purpose of the IBC, which is to assist in resolving distressed assets. Therefore, there is a requirement for a change in outlook towards the OCs and their classification²¹.

The purpose of writing this research paper is to analyse the position of the OCs during CIRP, to scrutinise whether the treatment provided to them is procedurally and substantially fair, to understand the Courts' approach towards the OCs and finally, to compare the IBC with the U.S. Bankruptcy Code to identify the best practices that can be transplanted in India.

II. CONCEPTUAL FRAMEWORK

A. Statement of Problem

The OCs play an important role in providing goods and services essential in the day-to-day running of the business. However, the IBC seems to be treating them like a step-son. The Code has given preferential treatment to FCs in the CIRP process and recovery of dues. However, OCs face multiple challenges, such as a lengthy and complicated CIRP initiation process, no representation on CoC, in case representation is allowed after prescribed thresholds are met, no right to vote or to be heard is provided to them. If there is any possibility that the dues are disputed, the Appellate Authority may not admit claims of OCs for the initiation of CIRP. The OCs are placed in the category of unsecured debts under Section 53, making it difficult for OCs to recover their dues. Additionally, the Court has, through various cases, upheld the position of FCs during the CIRP and liquidation process by citing the doctrine of commercial wisdom, establishing that FCs are the only capable body to make decisions related to the insolvency process. These circumstances prima facie show that OCs are being treated unfairly procedurally and substantively.

¹⁹ Apoorva Katti & Neha Venkatesh, A Critical and Comparative Analysis of the 'Waterfall Mechanism' Provided Under the Insolvency and Bankruptcy Code of 2016, 6(6) *Indian J. L. & Legal Rsch.* (2024).

²⁰ M. Jain, Safeguarding the Interests of MSMEs as Operational Creditors, *IBC Laws* (2020)

²¹ Hariharan R and Rabi Anandh R S, Operational Creditors - Lawfully Prejudiced

These conditions also adversely affect MSMEs and small businesses, which require access to funds to run their operations. These conditions may deter MSMEs or small businesses acting as suppliers and service providers from making long-term commitments, making it difficult for new businesses to establish supply chains. Such differential treatment with OCs may create challenges in running MSMEs' business and creation of new opportunities, which may hurt the country's economy in the long term.

B. RESEARCH GAPS:

IBC discriminates against OCs by giving preferential treatment to FCs during the CIRP and liquidation process. FCs are given decision-making rights and preference in the distribution of assets, while OCs are kept out of such decision-making process and given the least preference in the distribution of assets. Scholars have identified the problem, but few have discussed about substantive and procedural fairness. There is a need for more research on the question of substantive and procedural fairness in the substituted treatment given to OCs.

OCs are mainly trade creditors. Many of the MSMEs and small businesses that have limited resources and tight finances provide goods and services on credit to other businesses. In case a business to which they supply goods and services goes into insolvency, and due to differential treatment given to OCs, such suppliers risk recovering negligible or nil dues, are burdened with high compliance costs and thresholds due to provisions of IBC related to initiation of CIRP. In such a case, what will be the impact on such MSMEs and small businesses? There has been very limited research on this issue, which needs to be studied more by scholars and legislators.

C. Research Hypothesis

1. By giving participatory rights in the CoC meetings and CIRP, and greater priority in recovery of dues during liquidation, OCs may be better placed than their current position.
2. Separate provisions shall be made for MSMEs and small businesses to assist them in recovering their dues.

D. Scope and Limitation

This research paper covers the treatment of OCs under the IBC framework, studies the impact of the framework on the MSMEs and small businesses, and compares the treatment of OCs in India with laws in the U.S.A. Therefore, this research paper may be helpful in research related to analysing the position of OCs in insolvency law jurisprudence, the difference between the treatment of FCs and OCs under IBC, the impact of the treatment of OCs on MSMEs or small

businesses engaged in the supply of goods or provision of services and analysing legal frameworks of the U.S.A. related to the treatment of OCs or trade creditors.

A limitation of this paper is that, due to resource limitations and non-availability of required data, empirical research or any behavioural or quantitative analysis could not be conducted. Therefore, this research does not cover the practical implications of the IBC framework on OCs and concurrently on MSMEs and small businesses.

III. CONCEPT OF OC AND OPERATIONAL DEBT

The term OC refers to a person to whom an operational debt is owed. Any person to whom the amount of debt is legally transferred or assigned may also be termed an OC. Operational debt is debt incurred for the provision of goods or services or for the payment of government dues. Thus, OCs include vendors, suppliers, service providers, and the government, among others, who are engaged in the provision of goods and services²².

The terms OC and operational debt are defined under Sections 5(20) and 5(21) of the IBC. OC has been defined under Section 5(20)²³ as “*a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred*”. Operational debt is defined in Section 5(21)²⁴ as “*a claim in respect of the provision of goods or services, including employment, or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority*”.

Therefore, an OC can be categorised into three different classes for ascertaining the manner of distribution of the dues to them. They are as follows²⁵:

- a. Persons supplying goods and rendering services, and thereby entitled to recover the dues against such goods supplied or services rendered.
- b. Employees who provided services and are thereby entitled to the dues against rendering of such services.
- c. Central Government, State Government or local authority entitled to statutory dues even though not having rendered any services.

From the above analysis, it is evident that the OC refers to any person who is entitled to the amount of goods or services provided for the business of CD, who provides services in the ambit

²² IBC Process for Suppliers, National E-Governance Services Ltd.

²³ Insolvency and Bankruptcy Code, 2016, § 5(20), No. 31 of 2016, Acts of Parliament, 2016 (India).

²⁴ Insolvency and Bankruptcy Code, 2016, § 5(21), No. 31 of 2016, Acts of Parliament, 2016 (India).

²⁵ ‘Operational Creditors’ under Insolvency and Bankruptcy Code, 2016 – Experts’ Opinion, Taxmann

of his employment with the CD and dues towards government or local authorities. The operational debt is the sum of money owed towards the person who provided goods or services, the employee for rendering his services and the government.

The concept of OC and operational debt is not static. Two of the landmark judgements expanded the scope of OC to include trade unions and employment-related claims, and to the person paying an advance for acquiring goods or services. The following landmark cases expanded the scope of OC and operational debt:

A. JK Jute Mill Mazdoor Morcha vs. Juggilal Kamalpat Jute Mills²⁶:

In the said case, the trade union had raised a demand notice under Section 8²⁷ of IBC on behalf of workers demanding outstanding salaries which were due from the respondent and whose insolvency proceedings were pending under the Sick Industrial Companies Act, 1985²⁸. The NCLT and NCLAT both refused to consider the due wages as debt, stating that the trade union did not come under the definition of OC and directed each worker to file a separate application before NCLT to claim and recover their dues. The trade union filed an appeal against the NCLT's decision with the NCLAT, but it was dismissed. The matter was eventually appealed to the SC.

This raised a legal issue, whether a trade union could come under the definition of OC?

The SC referred and analysed the definitions of "trade union" under the Trade Unions Act, 1926²⁹ and that of "person" under the IBC, and inferred that the trade union shall fall under the definition of "person" under the IBC. The Court further referred to and analysed Section 15 (c) and (d) of the Trade Unions Act³⁰ and observed that the trade union has a right to use its general fund for prosecution or defence of any legal proceedings in which such trade union is a party, and also in any trade disputes on behalf of the trade union or its members. The Court also referred to the fact that, as per Section 13 of the Trade Unions Act³¹ The trade union can sue and be sued in its own name as a body corporate. Based on these facts, the SC set aside the decision of the NCLAT and held that any person duly authorised to make a claim of due amount shall be considered to be an OC.

B. Consolidated Construction Consortium Ltd. V. Hitro Energy Solutions Pvt. Ltd.³²:

²⁶ JK Jute Mill Mazdoor Morcha v. Juggilal Kamalpat Jute Mills Co. Ltd., (2019) 17 SCC 547

²⁷ Insolvency and Bankruptcy Code, 2016, § 8, No. 31 of 2016, Acts of Parliament, 2016 (India).

²⁸ The Sick Industrial Companies (Special Provisions) Act, 1985, No. 1 of 1986, Acts of Parliament, 1985 (India).

²⁹ The Trade Unions Act, 1926, No. 16 of 1926, Acts of the Indian Legislature, 1926 (India).

³⁰ Trade Unions Act, 1926, § 15, No. 16 of 1926, Acts of the Indian Legislature, 1926 (India).

³¹ Trade Unions Act, 1926, § 13, No. 16 of 1926, Acts of the Indian Legislature, 1926 (India).

³² Consolidated Construction Consortium Ltd. v. Hitro Energy Solutions Pvt. Ltd., (2022) 7 SCC 164

In this case, the appellant and Chennai Metro Rail Limited (CMRL) had agreed on the supply of light fittings, and the appellant, for fulfilling the same purpose, placed an order with a proprietary concern. The proprietary concern demanded an advance payment of Rs. 50 Lakh from the appellant, which was paid by cheque by CMRL. However, subsequently, the agreement between the appellant and CMRL was terminated, and the appellant paid Rs. 50 Lakh to CMRL and simultaneously demanded the due amount from the proprietary concern through a letter sent to the concern. However, the proprietary concern refused to pay the dues as it stated that it was not informed of the termination of the agreement and that it would pay directly to CMRL. A joint meeting between the concern and the appellant took place, wherein the proprietary concern demanded appellant obtain a letter from CMRL stating that the advance money is that of the appellant and shall not be claimed in future. However, despite obtaining the letter from CMRL and sending it to the proprietary concern, no payment was made to the appellant. Therefore, the appellant sent a letter to the proprietary concern seeking the payment of the due amount along with the interest, which was refused. Thereafter, the appellant sent a notice to the concern under Section 8³³ and demanded Rs. 83 Lakh, which was also refused by the concern. The insolvency proceedings against the concern (which was taken over by the defendant) were initiated under Section 9³⁴, which was admitted by NCLT, but it was dismissed later. An appeal was made to the NCLAT, which was also dismissed. Finally, an appeal was filed with the SC.

The legal issue raised in this case was whether the appellant is an OC, if he is a purchaser who paid money in advance.

The Court observed that the main dispute is between the proprietary concern and the appellant related to the debt. The Court, after interpreting the meaning of operational debt under Section 5(21)³⁵ and referring to the case of Pioneer Urban Land and Infrastructure Ltd. v. Union of India³⁶, observed that any debt arising from a payment made to a CD for supplying goods or services is to be considered as an operational debt. It also held that, as the appellant had requested an operational service from the defendant and made an advanced payment for the same, it shall fall under the category of OC.

It is through these landmark judgements that the trade unions claiming employment dues and persons paying an advance amount came under the ambit of OC.

³³ Insolvency and Bankruptcy Code, 2016, § 8, No. 31 of 2016, Acts of Parliament, 2016 (India).

³⁴ Insolvency and Bankruptcy Code, 2016, § 9, No. 31 of 2016, Acts of Parliament, 2016 (India).

³⁵ Insolvency and Bankruptcy Code, 2016, § 5(21), No. 31 of 2016, Acts of Parliament, 2016 (India).

³⁶ Pioneer Urban Land and Infrastructure Ltd. v. Union of India (2019) 8 SCC 416

IV. ECONOMIC DISSIMILARITIES BETWEEN FC AND OC

The IBC, through Section 5, distinguishes creditors into two categories, i.e. FC and OC. It also distinguishes between financial debt and operational debt. Section 5(7)³⁷ of the Code defines FC as a person to whom a financial debt is owed, and the term financial debt is defined under Section 5(8)³⁸ as any debt that is distributed against consideration for the time value of money. This clause also includes various sources of borrowing and raising of money as a financial debt. The OCs are defined under Section 5(20)³⁹ as any person to whom operational debt is owed, and operational debt is defined under Section 5(21)⁴⁰ as claims related to the provision of goods or services, which include employment and statutory dues.

The economic dissimilarities were highlighted through the judgment of the SC in the case of **Swiss Ribbons Pvt. Ltd. v. Union of India**⁴¹ and the **BLRC report**. The report had already recommended classification of creditors into two categories based on differences between them. The classification of creditors under IBC was challenged in the case of Swiss Ribbons, and the distinction between the creditors was alleged to have violated the principle of equality under Article 14 of the Constitution. The SC, in this judgment, deeply analysed the provisions of the Code and the BLRC report⁴².

The BLRC report⁴³ and the Court, through the Swiss Ribbons judgement, differentiated between the nature of claims of FCs and OCs. The report states that FCs are persons who have relationships based on pure financial contracts, such as secured debt or a loan, whereas persons whose debts or liabilities are incurred by the entity through commercial transactions are termed as OCs. The Court, in the Swiss Ribbons case, observed that FCs are generally secured creditors, while OCs are unsecured, because dues related to the provision of goods and services are not secured by collateral, unlike mortgage payments.

The nature of contracts of FCs and OCs is also different, as contracts of FCs are generally related to the term loans and involve a large sum of money, enabling the CD to operate its business for a long period of time. While contracts of OCs are generally related to the provision of goods and services to the business of CD. It was also observed that the FCs are better

³⁷ Insolvency and Bankruptcy Code, 2016, § 5(7), No. 31 of 2016, Acts of Parliament, 2016 (India).

³⁸ Insolvency and Bankruptcy Code, 2016, § 5(8), No. 31 of 2016, Acts of Parliament, 2016 (India).

³⁹ Insolvency and Bankruptcy Code, 2016, § 5(20), No. 31 of 2016, Acts of Parliament, 2016 (India).

⁴⁰ Insolvency and Bankruptcy Code, 2016, § 5(21), No. 31 of 2016, Acts of Parliament, 2016 (India).

⁴¹ Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 SCC 17 (India).

⁴² A. Nehra, Fundamentals of IBC: Financial Creditor v. Operational Creditor, PSL Advocates And Solicitors (Apr. 27, 2021)

⁴³ Bankruptcy Law Reforms Committee, The Report Of The Bankruptcy Law Reforms Committee, Volume I: Rationale And Design (2015).

equipped to analyse the viability of the business of CD, and banks are in a position to conduct a background check of CD and a market study before sanctioning a loan; therefore, placing them in a position to evaluate the resolution plan properly. However, as the OCs are only concerned with the recovery of dues incurred from the provision of goods and services, they are not reliable for examining the viability of a business. The report also agreed with the position of FCs in assessing the viability of CD. The report emphasised that the CoC will need to include creditors who can assess the business's viability and may change the terms of existing liabilities during negotiations. And therefore, OCs, being concerned only with recovering their dues, the committee, through the report, recommended that CoC be restricted to FCs.

The Court observed that the FCs are better at keeping proper documentation of the loans and dues owed from CDs and are able to prove their dues through proper documentation and records, while the same is not the case with OCs, who may not have proper records with them. The committee, through its report, also confirmed the fact that the FCs generally have electronic records of liabilities that are submitted to Information Utilities and can be verified by accessing the system. On the other hand, OCs may file evidence in electronic or physical form, as not all OCs may have the facility to file liability of CDs electronically.

Therefore, the BLRC report and the judgment of the Court in the Swiss Ribbons case highlighted and explained the rationale behind the economic dissimilarities between the treatment of FCs and OCs, and the Court also held that such differentiation is intelligible and therefore does not violate Article 14 of the Constitution.

V. POSITION OF OC IN IBC DURING CIRP AND DISTRIBUTION OF ASSETS:

A. Initiation of CIRP:

CIRP is a process of reviving a defaulting company from unpaid loans and dues from multiple lenders or creditors, and is undertaken by various stakeholders against the CD⁴⁴. The process may be initiated by FC, OC or CD himself or if CD commits a default⁴⁵. Section 6⁴⁶ authorises FC, OC or CD himself to initiate the CIRP process against the CD for the default committed by him.

Sections 8 and 9 provide the process of initiation of the CIRP process against CD by OC.

⁴⁴ C. V. Gouri, Corporate Insolvency Resolution Process: An Overview of the Procedural Regime and its Economic Relevance, 7(2) *Int'l J. Legal Sci. & Innovation* 734 (2025).

⁴⁵ S. R. Panyam et al., Comparative Analysis of Corporate Insolvency Resolution Process of Financial and Operational Creditor in India, 6(4) *Int'l J. L. Mgmt. & Human.* 2513 (2023).

⁴⁶ Insolvency and Bankruptcy Code, 2016, § 6, No. 31 of 2016, Acts of Parliament, 2016 (India).

Section 8⁴⁷ mandates the OC to first send a demand notice to the CD, along with a copy of an invoice of the amount in default. Thereafter, the CD shall either make a payment of operational debt by sending prescribed documents to the OC or bring to the notice of the OC the existence of any dispute before receiving such notice within ten days from receiving such notice.

Section 9⁴⁸ authorises the OC to initiate CIRP if it does not receive the amount demanded or any notice of the existence of a dispute from CD within the prescribed period by filing an application with the Adjudicating Authority requesting the initiation of CIRP along with the required fees, documents, and proofs as prescribed under the provision. The OC may also appoint RP to act as IRP during the insolvency process. The AA may, within fourteen days of receiving an application from the OC, admit the application if it is satisfied with the completeness of the application, and after considering that the notice had been sent by the OC to the CD, and no payment of unpaid dues or notice related to a dispute over the dues has been received from the CD and such other conditions mentioned in the provision. However, in case of non-deliverance of notice by OC, payment of dues by CD, incompleteness of application or in case of pendency of any dispute, the AA may reject the application.

This is in contrast with the simpler process for initiation of CIRP by FCs under Section 7⁴⁹, wherein the FC can file an application with AA to initiate CIRP without giving prior notice to the CD for payment of dues, and the CIRP is initiated from the date of admission of the application. The application is only rejected if the AA is satisfied that the default has not occurred or disciplinary proceedings are pending against RP.

B. Composition of CoC and Representation of OC:

Section 21⁵⁰ provides for the constitution of CoC by the IRP after receipt of all claims and after considering the financial position of the CD. This committee shall comprise exclusively of FCs. In case a creditor is FC as well as OC or OC has assigned his operational debt to FC, such creditor shall be FC to the extent of financial debt owed to him, and shall be admitted to CoC only to the extent of such financial debt.

Section 24⁵¹ lays provisions related to the meeting of the CoC. It authorises OC, whose aggregate dues are not below ten percent of the total debt, to attend the meetings of CoC. However, OC is not allowed to vote in the meeting of CoC, and the absence of representatives

⁴⁷ Insolvency and Bankruptcy Code, 2016, § 8, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁴⁸ Insolvency and Bankruptcy Code, 2016, § 9, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁴⁹ Insolvency and Bankruptcy Code, 2016, § 7, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁵⁰ Insolvency and Bankruptcy Code, 2016, § 21, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁵¹ Insolvency and Bankruptcy Code, 2016, § 24, No. 31 of 2016, Acts of Parliament, 2016 (India).

of OCs does not invalidate the proceedings of the meeting. On the other hand, the FCs can vote in accordance with their share in the financial debt of such a CD.

C. Payment to OC under Resolution Plan

Section 30(2)(b)⁵², provides for repayment of operational dues to OC. According to this provision, the payment specified by the board under the resolution plan shall not be less than the amount paid in case of liquidation of CD under Section 53⁵³ or the amount which would be paid to the creditors if the amount had been distributed as per the resolution plan under Section 53 (1)⁵⁴. This safeguard was implemented in accordance with the Essar Steel case judgement.

However, it is imperative to note that under Regulation 38 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016⁵⁵, the OCs are given priority over FCs for payment of the amount under the resolution plan. Additionally, Regulation 38 (1A)⁵⁶ requires a resolution plan to include a statement of how FCs, OCs and other stakeholders are dealt with.

D. Absence of OCS in the Mechanism of Distribution of Assets:

There is no mention of OCs in the list of distribution of assets under Section 53. Secured creditors have been given preference in the distribution of assets after satisfaction of workmen's dues. However, satisfaction of residuary dues and debts is included in the last of the entries in the list. The OCs fall under the category of “remaining debts and dues”, which is the last category in the list of distribution of assets, just above the category of equity shareholders.⁵⁷

Non-obstante clause

Section 238⁵⁸ of the Code is a non-obstante clause that establishes the superiority of the IBC over other debt recovery laws in force. This means that for the debt recovery process, the provisions of IBC shall have force over the regulations of other laws. Therefore, for the recovery of dues, the creditors shall be required to follow the procedure laid down by the IBC over other laws.

⁵² Insolvency and Bankruptcy Code, 2016, § 30(2)(b), No. 31 of 2016, Acts of Parliament, 2016 (India).

⁵³ Insolvency and Bankruptcy Code, 2016, § 53, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁵⁴ Insolvency and Bankruptcy Code, 2016, § 53(1), No. 31 of 2016, Acts of Parliament, 2016 (India).

⁵⁵ Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 38 (India).

⁵⁶ Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 38 (1A) (India).

⁵⁷ Apoorva Katti & Neha Venkatesh, A Critical and Comparative Analysis of the ‘Waterfall Mechanism’ Provided Under the Insolvency and Bankruptcy Code of 2016, 6(6) Indian J. L. & Legal Rsch. (2024).

⁵⁸ Insolvency and Bankruptcy Code, 2016, § 238, No. 31 of 2016, Acts of Parliament, 2016 (India).

VI. CASE LAWS

The jurisprudence of insolvency law has evolved drastically through judicial precedents propounded by tribunals and the SC. Also, questions over the issue of fairness were answered through these landmark judgments. We shall analyse important cases that contributed immensely towards determining the position of OCs in IBC.

A. **BINANI INDUSTRIES LTD. V. BANK OF BARODA**⁵⁹:

Binani Industries was admitted into insolvency proceedings under the provisions of IBC, and RP had constituted CoC and was accepting resolution plans. Two plans were received, one from Rajputana Properties Pvt. Ltd. (RPPL) and the other from Ultratech Cement Ltd. (UCL). However, the CoC did not consider the resolution plan submitted by UCL and proceeded with the plan submitted by RPPL. The plan was approved in a meeting of CoC with a majority; however, some creditors noted a protest while voting in favour of the plan. A suit was filed alleging discrimination by the CoC, and the matter reached to NCLAT.

An issue was raised whether a resolution plan that discriminates against some creditors can be approved.

The NCLAT held that any plan that discriminates against certain FCs and OCs or between two similarly placed creditors, without stating a valid reason, shall be deemed illegal and shall be ineligible to be approved. NCLAT also observed that the CoC had acted mechanically and without application of mind, and discrimination in favour of RPPL was evident. The NCLAT approved UCL's resolution plan, which had more favourable terms than the earlier one. The NCLAT also made an important observation, emphasising the equal treatment of FCs and OCs. The tribunal observed that neither the maximisation of the value of assets of the CD can be ignored nor the need to balance the needs of various stakeholders. The tribunal opined that if OCs are ignored and provided merely with the liquidation value due to misunderstanding and misreading of Section 30 (2) (b), then no creditor will supply goods or services to the CD on a credit basis, and suppliers may ask for advance payments for the provision of goods and services, which may undermine the purpose of IBC and affect the Indian economy. Therefore, any resolution plan that is discriminatory towards any FC or OC shall be against the provisions of this code.

B. **SWISS RIBBONS PVT. LTD. V. UNION OF INDIA**⁶⁰:

⁵⁹ Binani Industries Ltd. v. Bank of Baroda, Company Appeal (AT) (Insolvency) No. 82 of 2018 (NCLAT, India).

⁶⁰ Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 SCC 17 (India).

Several writ petitions were filed with the SC challenging the constitutional validity of many provisions of the IBC. The petitioners, along with other provisions of IBC, challenged the classification of creditors into FC and OC, stating it to be discriminatory and violative of Article 14 of the Constitution and also challenged the validity of Sections 21, 24 and 53⁶¹ and held them to be against the principles of Article 14⁶².

The following issues were raised and analysed in this case:

- a. Whether the classification between FCs and OCs is discriminatory and violative of Article 14 of the Constitution?
- b. Whether or not Sections 21 and 24, which do not provide OC voting rights in CoC, are discriminatory under Article 14?
- c. Whether Section 53, which provides a list of priorities of distribution of assets during liquidation, violates Article 14?

The SC held that the classification between FCs and OCs is not discriminatory or violative of Article 14. SC gave several reasons for coming to such a conclusion. SC observed that the FCs were generally banks and financial institutions that were secured creditors, while OCs were unsecured creditors seeking payments for the provision of goods and services and payments by workers, which were not secured by mortgage or similar documents. Additionally, the nature of claims and contracts of FCs was different from that of OCs, as FCs granted term loans or working capital, enabling CD to set up and operate his business, while OCs merely supplied goods and services as raw material for this business. Financial debts also involve large sums of money and have a specific schedule for repayment, and default of such debt enables FCs to recall the provided loan or debt. On the other hand, the quantum of operational debts is usually less than that of financial debt. Also, operational debts are recurring in nature, with a high possibility of disputes arising in operational debts compared to financial debts, as financial debts are properly documented, which is not the case with operational debts. Based on these reasons, the SC upheld the classification of FCs and OCs.

The SC scrutinised the validity of Section 21⁶³ and 24⁶⁴ of the Code. The SC observed that the FCs, usually being banks and financial institutions engaged in the business of money lending, are in a position to examine the viability of the business of the CD and at the time of granting loans, the FCs undertake a detailed study of the market conditions before sanctioning the loan.

⁶¹ Insolvency and Bankruptcy Code, 2016, § 21,24 and 53, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁶² Constitution of India, art. 14 (1950).

⁶³ Insolvency and Bankruptcy Code, 2016, § 21, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁶⁴ Insolvency and Bankruptcy Code, 2016, § 24, No. 31 of 2016, Acts of Parliament, 2016 (India).

The OCs are only interested in recovering the dues incurred while supplying the goods and services, and are not in the position of assessing or analysing the business of the CD. Regulation 38 of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016⁶⁵, strengthens the rights of OCs by preferring OCs over FCs while preparing a resolution plan. Therefore, based on these observations, SC observed that the provisions laid out in Sections 21⁶⁶ and 24⁶⁷ are not violative of Article 14.

Lastly, while scrutinising the validity of Section 53⁶⁸, the Court emphasised the importance of the difference between financial debts, which are generally secured and operational debts, which are usually unsecured. The repayment of debts of FCs assists in infusing capital into the economy, which FCs may lend to other businesses. This creates the basis for an intelligible difference between financial debts and operational debts, which satisfies the object of IBC. For the purpose of protecting legitimate interests, the workmen's dues have been given priority above all other debts, despite being unsecured debts. Based on these reasons, the SC also upheld the status of Section 53⁶⁹ and dismissed the challenge of the petitioners.

Therefore, through this judgment, the Court upheld that the classification between FCs and OCs is not discriminatory and Sections 21, 24 and 53 are valid and not violative of Article 14 of the Constitution.

C. COMMITTEE OF CREDITORS OF ESSAR STEEL LTD. V. SATISH KUMAR GUPTA⁷⁰:

The CIRP had been initiated against Essar Steel, and RP had invited applications for resolution plans. Two contenders, ArcelorMittal India Pvt. Ltd. and Numetal Ltd., had submitted applications for the same; however, both of them were found to be ineligible. They were directed to make the required payments to their creditors to become eligible. ArcelorMittal made necessary payments and submitted its resolution plan, which was accepted by the CoC. However, the matter had reached NCLAT, wherein the tribunal directed that the resolution plan shall not differentiate between FCs and OCs and both creditors are required to be treated equally while distributing the assets or making payment of dues; OCs can be categorised into different sub-classes; Section 53⁷¹ shall be applied only in case of liquidation, and CoC shall not be

⁶⁵ Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 38 (India).

⁶⁶ Insolvency and Bankruptcy Code, 2016, § 21, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁶⁷ Insolvency and Bankruptcy Code, 2016, § 24, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁶⁸ Insolvency and Bankruptcy Code, 2016, § 53, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁶⁹ *ibid*

⁷⁰ Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta, (2019) 16 SCC 479 (India).

⁷¹ Insolvency and Bankruptcy Code, 2016, § 53, No. 31 of 2016, Acts of Parliament, 2016 (India).

empowered in decision-making related to the manner of distribution of assets among one or more creditors, as FCs would favour themselves, resulting in resulting in conflict of interest between FC and OC. Thereafter, the matter reached the SC.

Multiple issues were raised in this case:

- a. Whether FCs and OCs shall be treated equally
- b. Whether the Court can interfere in the commercial decision of CoC
- c. Whether CoC is empowered to make decisions

The Court, in relation to the decision-making power of CoC, observed that the resolution of CD depends on the majority vote of the CoC and management of CD or RP cannot do anything that impacts the major decision of the CoC between the transition of power from management of CD to management of the resolution plan, which has been accepted by the majority of CoC. Whether or not to rehabilitate the CD is the decision through the commercial decision of CoC by accepting a resolution plan, and the ultimate decision is made by majority vote of the committee. Therefore, the Court, through this judgment, held that how CIRP takes place is the commercial wisdom of the majority of the creditors who determine the same through negotiations with the prospective applicants and also the manner of CIRP.

Regarding the issue of the involvement of the judiciary in the commercial decision-making of the CoC, the Court held that the judiciary shall not interfere if the interests of all the creditors are taken into account.

On the question of whether the FCs and OCs shall be treated equally, the SC held that the principle of equality shall not mean that all the creditors be treated equally and have equal share in recovery of dues in the resolution plan as directed by NCLAT. The SC further clarified that different treatment based on security value is permissible even in the case of secured FCs. The Court also observed that in case the security interests of creditors are disregarded, many creditors will become eligible to vote during the process of CIRP, which would defeat the objective of IBC of ensuring proper resolution of distressed assets. SC also observed that the FCs and OCs cannot be placed equally due to differences in their business relations with CD. However, the SC held that IBC provides sufficient safeguards for OCs, and until all the resolutions are complied with, CoC could approve and move forward with a plan that includes a differential payment plan for categories of FCs and OCs.

VII. QUESTION OF SUBSTANTIVE AND PROCEDURAL FAIRNESS

After analysing the cases in the above section, it is important to analyse whether OCs are treated

fairly. We shall analyse two aspects of fairness. One is procedural fairness, meaning whether regulations treat OCs fairly or not and substantive fairness.

A. Substantive Fairness:

Section 30(2)(b)⁷² of the Code mandates that during submission of the resolution plan, OCs shall be paid not less than the amount that was to be paid to the creditors during liquidation as per Section 53⁷³ or amount paid to creditors during the resolution plan if the amount is distributed as per the order of priority mentioned under Section 53 (1), whichever is higher.

The Regulation 38 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016⁷⁴ gives preference to OCs over FCs by stating that OCs are to be given priority over FCs for the amount to be paid under a resolution plan. Regulation 38 (1A)⁷⁵ mandates a resolution plan to have a statement of how it deals with the interests of stakeholders, including FCs and OCs of the CD.

However, in the case of **Essar Steel**⁷⁶, the Court established the supremacy of the CoC and its decision-making powers on the fate of CD during the CIRP and liquidation process, thereby enabling the CoC to make decisions according to its commercial wisdom. Additionally, the Court also upheld the differential treatment between the FCs and OCs while determining the payment of dues out of the assets of CD.

On the other hand, Section 53⁷⁷ provides an order of distribution of assets which lists secured creditors in top priority after the insolvency dues and workmen payments categories. However, unsecured creditors are in one of the last positions before the payment to shareholders category. Unsecured creditors are those whose dues are not backed by any security and generally include suppliers, service providers and trade creditors⁷⁸.

However, in the case of **State Tax Officer v. Rainbow Papers Limited**⁷⁹, the SC, while deciding the status of government dues, read Section 48 of the Gujarat Value Added Tax Act⁸⁰ alongside Section 53⁸¹ of the IBC and other relevant provisions. Section 48 of the Gujarat VAT

⁷² Insolvency and Bankruptcy Code, 2016, § 30(2)(b), No. 31 of 2016, Acts of Parliament, 2016 (India).

⁷³ Insolvency and Bankruptcy Code, 2016, § 853 No. 31 of 2016, Acts of Parliament, 2016 (India).

⁷⁴ Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 38.

⁷⁵ Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 38(1A).

⁷⁶ Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta, (2019) 16 SCC 479

⁷⁷ Insolvency and Bankruptcy Code, 2016, § 53, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁷⁸ H. Arora, Statutory Charges and Secured Status: Rethinking Priority Claims in IBC Liquidation, 7(3) Int'l J. Multidisciplinary Rsch. (2025).

⁷⁹ State Tax Officer v. Rainbow Papers Ltd., (2022) 9 SCC 330 (India).

⁸⁰ Gujarat Value Added Tax Act, 2003, § 48, No. 1 of 2005, 2005 (India).

⁸¹ Insolvency and Bankruptcy Code, 2016, § 53, No. 31 of 2016, Acts of Parliament, 2016 (India).

Act⁸² stated that any amount payable by any person liable to pay to the Government as tax, interest or any penalty shall be the first charge on the property of such person, and nothing shall be contrary to the said law. The SC, by referring to these provisions, held the government to be a secured creditor in case of the collection of statutory dues.

The impact of this case was such that the Court altered the order provided in Section 53⁸³ and allowed statutory dues to supersede other claimants, created uncertainty over the finalisation of the resolution plans accepted by the CoC and created uncertainty for applicants who became reluctant to participate in insolvency proceedings⁸⁴. However, in the case of **Paschimanchal Vidyut Vitran Nigam Ltd. V. Raman Ispat Pvt. Ltd.**⁸⁵, the SC held that a statutory claim to create a charge does not prioritise the status of the government to be a secured creditor and observed that IBC, being a self-contained code, the rights provided by statutes of the state shall be interpreted within the confinement of the IBC.

B. Procedural Fairness:

Sections 8 and 9 of the IBC enable the OC to initiate CIRP and lay down its process. However, when compared with Section 7, the process is lengthy and time-consuming. Additionally, Section 9 mandates that the claim shall not be under any dispute for successful initiation of the CIRP. If there is any dispute, the claim is rejected. In the case of **Mobilox Innovations Pvt. Ltd. v. Kirusa Software Pvt. Ltd.**, the SC held that if there is any pre-existing dispute regarding the debt, the application of such OC shall be rejected. This puts an additional burden on OCs as they have to prove that the claim is undisputed for initiating CIRP⁸⁶. However, Section 7⁸⁷ of IBC provides a simpler procedure for FCs to initiate the insolvency process, and the application of FCs is rejected if it is proved that the default has not occurred or any disciplinary proceedings are ongoing against RP.

Section 21⁸⁸ provides for the CoC to be composed only of FCs. Section 24⁸⁹ allows OCs to attend meetings of CoC if dues payable to them exceed the prescribed threshold. However, they are not allowed to vote during the meetings. The dominance of FCs in CoC has been upheld in the Swiss Ribbons case, wherein the Court held FCs to have commercial wisdom in taking

⁸² Gujarat Value Added Tax Act, 2003, § 48, No. 1 of 2005, 2005 (India).

⁸³ Insolvency and Bankruptcy Code, 2016, § 53, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁸⁴ Arora, H. (2025). Statutory charges and secured status: Rethinking priority claims in IBC liquidation. *International Journal for Multidisciplinary Research (IJFMR)*, 7(3), May–June.

⁸⁵ *Paschimanchal Vidyut Vitran Nigam Ltd. v. Raman Ispat Pvt. Ltd.*, (2023) 8 SCC 93.

⁸⁶ Priya Kumari, *Operational Creditors Under the IBC: Unequal Footing or Justified Differentiation?* 7(3) *Int'l J. Multidisciplinary Rsch.* (2025).

⁸⁷ Insolvency and Bankruptcy Code, 2016, § 7, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁸⁸ Insolvency and Bankruptcy Code, 2016, § 21, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁸⁹ Insolvency and Bankruptcy Code, 2016, § 24, No. 31 of 2016, Acts of Parliament, 2016 (India).

decisions in relation to the insolvency proceedings of CD.

Moreover, the threshold for initiation of CIRP is Rupees One Crore, which adversely affects OCs who wish to initiate CIRP, but have claims less than Rupees One Crore. Additionally, Section 12⁹⁰ mandates the CIRP to be concluded within 330 days; failure to attain the same may lead to compulsory liquidation. This time limit is compulsorily enforced by the Court in the judgment of Essar Steel. This may result in OCs not getting enough time to address their concerns during the CIRP.

C. Final Analysis:

From the analysis of the above points, it is clear that OCs are not fairly treated substantively or procedurally. OCs suffer from substantive unfairness because even though certain provisions of IBC and IBBI regulations provide safeguards as to payment of dues during the insolvency process, the process is still controlled and managed by the CoC, dominated by the FCs. The position of FCs in CoC has been cemented by the judgment in the Essar Steel case, which cites the commercial wisdom of FCs. Judgments such as Rainbow Papers create more ambiguity related to the order of payment of dues during the distribution of assets of the CD, thereby marginalising OCs. Moreover, the Courts have, in the case of Swiss Ribbons, justified the differential treatment between two categories of creditors, permanently treating OCs as a secondary class, with no further recourse.

Procedurally, too, the OCs are treated unfairly, as they are not heard during the insolvency proceedings, with decisions of the CoC being binding on all the stakeholders. Even the procedure for initiation of insolvency proceedings is lengthy and time-consuming, with the burden of proof that the dues are not under dispute on the OCs themselves. In the list of distribution of assets, OCs are not specifically mentioned and are therefore categorised into unsecured debtors, who rank last in the list, just above shareholders. The threshold for the minimum amount of default required to initiate an insolvency proceeding is also high. This reduces the chances of OCs recovering their dues, which may hurt them financially.

VIII. IMPACT OF DIFFERENTIAL TREATMENT OF OPERATIONAL CREDITORS ON MSMEs AND SMALL BUSINESSES

Micro, Small and Medium Enterprises (MSMEs) have played an important part in the Indian economy and are referred to as the power engines of the economy due to their ability to create

⁹⁰ Insolvency and Bankruptcy Code, 2016, § 12, No. 31 of 2016, Acts of Parliament, 2016 (India).

multiple job opportunities⁹¹. As the IBC categorises creditors into FCs and OCs, MSMEs are mostly treated as OCs, as they are usually engaged in the provision of goods and services to the corporate debtors⁹².

Under IBC, OCs are burdened to comply with procedural compliances to initiate CIRP. After the commencement of the process, FCs enjoy an exclusive and dominant position in the CoC along with voting powers for decision-making related to approving or rejecting a resolution plan. At the same time, OCs take a back seat as they are excluded from being a part of CoC, except in cases where CD does not owe any debt to any FC. Even during the process of recovering dues, OCs are ranked much lower than FCs. Even though the Court has tried to reason by stating that FCs are better at assessing the viability of business, while OCs are only interested in recovery of their dues, in practicality, such a distinction has led to discriminatory results, wherein the recovery rate for OCs is very negligible, irrespective of the size of their claims⁹³.

Such marginalisation of OCs impacts MSMEs as they operate on limited cash flows, making them vulnerable to delays in payments as non-payment of dues because of the entry of large debtor into the insolvency process may hamper their operations and push them towards insolvency. They may be left without any available options as they may not be equipped with the required strength, financially and legally, to contest claims against CD, track proceedings and challenge resolution plans⁹⁴.

Additionally, as MSMEs providing goods or services are treated as OCs under the IBC, they are impacted similar to that of OCs by the various provisions of the IBC, such as lengthy CIRP initiation processes, no place in the constitution of CoC unless certain thresholds are met, no power to exercise voting rights in the meeting of CoC and positioning of unsecured creditors in lowest order in the waterfall mechanism.

Another issue for MSMEs is that of the threshold amount for default, which was raised to Rupees One Crore in the year 2020, resulting in fewer OCs applying for the IBC process. Experts opined that due to higher thresholds, MSMEs were not able to mobilise the required amount for initiating insolvency proceedings and thus, have lost the remedy under the

⁹¹ Decoding the Position of MSMEs Under the Regime of IBC, SIGNALX.

⁹² D. Sampat, Operational Creditors and MSMEs under the IBC

⁹³ Treatment of Operational Creditors under Insolvency and Bankruptcy Code, 2016: An Analysis of Recent Jurisprudence, LiveLaw

⁹⁴ Priya Kumari, Operational Creditors Under the IBC: Unequal Footing or Justified Differentiation? 7(3) Int'l J. Multidisciplinary Rsch. (2025).

provisions of IBC⁹⁵.

Another issue is Section 238⁹⁶ of IBC, which is a non-obstante clause that makes the provisions of IBC effective over the provisions of other statutes. For facilitating MSMEs, the MSMED Act⁹⁷ laid down provisions related to the payment of dues to the MSMEs. However, because of the non-obstante clause under IBC, no actions could be instituted under the MSMED Act, stalling all other pending proceedings under the Act⁹⁸. This has left no option for MSMEs but to follow the IBC proceedings to recover their dues. However, considering the problems discussed earlier, it will be time-consuming and burdensome on MSMEs to take the path of IBC.

IX. COMPARATIVE ANALYSIS OF INSOLVENCY LAWS WITH THE UNITED STATES OF AMERICA

Comparative analysis of international jurisdictions is important for identifying best practices related to the treatment of OCs in insolvency law. We shall compare the insolvency law of India with that of the USA, and analyse how OCs or creditors of a similar class are treated.

Chapter 11 of the US Bankruptcy Code⁹⁹ deals with insolvency proceedings in the USA. Under this code, trade creditors are treated as unsecured creditors, and creditors are bifurcated into different classes consisting of similar dues. The following are the important provisions dealing with creditors during the insolvency and bankruptcy process:

A. INITIATION OF BANKRUPTCY SUIT:

Under Section 301¹⁰⁰, the debtor may voluntarily initiate a suit for bankruptcy, while under Section 303¹⁰¹, any person of the prescribed category who meets the prescribed thresholds can initiate a suit for bankruptcy against the debtor. After the suit for bankruptcy has been filed, Section 362¹⁰² mandates an automatic stay on filing, continuation, commencement and enforcement of all actions, claims and judicial decisions.

⁹⁵ D. Sampat, Operational Creditors and MSMEs under the IBC.

⁹⁶ Insolvency and Bankruptcy Code, 2016, § 238, No. 31 of 2016, Acts of Parliament, 2016 (India).

⁹⁷ Micro, Small and Medium Enterprises Development Act, 2006, No. 27 of 2006, Acts of Parliament, 2006 (India).

⁹⁸ M. Jain, Safeguarding the Interests of MSMEs as Operational Creditors, IBC Laws

⁹⁹ United States Bankruptcy Code, 11 U.S.C. (2023).

¹⁰⁰ United States Bankruptcy Code, 11 U.S.C. § 301 (2023).

¹⁰¹ United States Bankruptcy Code, 11 U.S.C. § 303 (2023).

¹⁰² United States Bankruptcy Code, 11 U.S.C. § 362 (2023).

B. APPLICATION FOR REIMBURSEMENT OF EXPENSES AND RETURN OF GOODS:

Section 503¹⁰³ allows the entities to file an application with the Court for reimbursement of administrative expenses. A person, through this process, can claim reimbursement of goods sent to the debtor within twenty days of filing for bankruptcy. Section 507¹⁰⁴, which regulates priority of payment of claims and expenses, gives preference to payment of claims under Section 503 and also payment of wages, salaries and other expenses to the employees. Additionally, under Section 546¹⁰⁵, the seller can reclaim his goods from the debtor if he has sold the goods to such an insolvent debtor, within forty-five days from the initiation of bankruptcy. For reclaiming such goods, the seller is required to file a written notice demanding the reclamation of such goods within forty-five days of the debtor receiving such goods or if the period of forty-five days has expired, then within twenty days of commencement of the case.

C. PROTECTION AGAINST PREFERENCE AND FRAUDULENT TRANSACTIONS:

This code contains two safeguards. One is enacted in Section 547¹⁰⁶, which provides that the trustee may, based on proper due diligence and taking into account the circumstances of the case, avoid transfer of any claims, in case they benefit a creditor, or are used to repay an antecedent debt or made at the time of insolvency of the debtor, or occur within ninety days before filing of the suit and in case, the creditor is an insider, within one year or if there is a possibility that the creditor may receive more than what he is entitled under Chapter 7. The other is Section 548¹⁰⁷, which provides that the trustee may avoid a transfer of interest in any property or obligation incurred by the debtor within two years before the petition was filed if the debtor made such a transaction to hinder, delay, or defraud an entity to which the debtor owed a debt. The trustee may also avoid transfer based on other circumstances provided in the Section.

D. CONSTITUTION OF COMMITTEE OF CREDITORS AND CONSOLIDATION OF SIMILAR CLAIMS

Section 1104¹⁰⁸ provides for the constitution and appointment of a committee of creditors. An additional committee of creditors may be appointed if permitted by the Court. The committee

¹⁰³ United States Bankruptcy Code, 11 U.S.C. § 503 (2023).

¹⁰⁴ United States Bankruptcy Code, 11 U.S.C. § 507 (2023).

¹⁰⁵ United States Bankruptcy Code, 11 U.S.C. § 546 (2023).

¹⁰⁶ United States Bankruptcy Code, 11 U.S.C. § 547 (2023).

¹⁰⁷ United States Bankruptcy Code, 11 U.S.C. § 548 (2023).

¹⁰⁸ United States Bankruptcy Code, 11 U.S.C. § 1104 (2023).

of creditors shall consist of persons holding the seven largest claims against the debtor or of members of the committee of creditors that was organised before the filing and initiation of the case. Additionally, it is the duty of the committee to provide information to the creditors holding claims represented by the committee but are not appointed to the committee and receive comments from such creditors. Section 1122¹⁰⁹ allows grouping of similar claims into a particular class if their claims are substantially similar to other claims. The provision authorises a separate class consisting of unsecured claims to be formed.

E. ACCEPTANCE OF BANKRUPTCY PLAN:

Section 1126¹¹⁰ regulates the acceptance of a bankruptcy plan. It provides that a holder of a claim may accept or reject a plan. The plan is considered to be accepted by the class of claims if it is accepted by the creditors holding at least two-thirds of the amounts and half of the claims of each class of creditors. Moreover, the class that is not impaired under the plan and each claimant in such class is deemed to have accepted the plan and a separate solicitation of acceptances from them is not required.

F. CONFIRMATION BY THE COURT:

Finally, Section 1129¹¹¹ provides that the Court may confirm the plan if all the statutory requirements mentioned in this provision are fulfilled. Further, if all the conditions of this section are fulfilled and the plan is not discriminatory and is fair and equitable, then in such a case, the Court may, after a request from the proponent of the plan, confirm the same, and the plan shall be binding on all the classes of claimants.

G. COMPARATIVE ANALYSIS:

After analysing the bankruptcy provisions of the U.S. Bankruptcy Code, it is clear that the position of trade creditors is better than that of OCs in India. Under Sections 503, 507 and 546, trade creditors may apply to the Court and claim back the goods sold to the debtor within a specified period, a provision missing in the IBC. Under Section 1122, similar claims are consolidated into one class, and each class has the power to vote on a bankruptcy plan. Under Section 1104, the Committee of Creditors is formed by each class of creditors, which contains members who fulfil the prescribed threshold, but are under an obligation to disclose information to non-members. Therefore, under the U.S. Bankruptcy Code, the creditors are divided into classes based on the nature of their claims, but each class has been provided with the power to

¹⁰⁹ United States Bankruptcy Code, 11 U.S.C. § 1122 (2023).

¹¹⁰ United States Bankruptcy Code, 11 U.S.C. § 1126 (2023).

¹¹¹ United States Bankruptcy Code, 11 U.S.C. § 1129 (2023).

vote on the bankruptcy plan and the members of CoC are required to provide non-members with proper information related to the plan. This is in contrast to the IBC, which provides no power to OCs in CoC meetings, and there is no provision in the IBC to reimburse expenses of goods delivered within a specified period of initiation of CIRP. Moreover, the process of initiating a bankruptcy suit in the U.S. is the same for all persons. Therefore, unlike Sections 7, 8 and 9 of the IBC, there is no differentiation between the classes of creditors to initiate a bankruptcy suit against the debtor. Such provisions giving more power and information disclosures to OCs during the CIRP and liquidation process shall be implemented in India for their welfare.

X. PROPOSALS FOR REFORM AND CONCLUSION

A. Proposals for Reform

- a. The process for initiation of CIRP for OCs under Sections 8 and 9 is lengthy and time-consuming, which forces OCs to bear a higher level of compliance and imposes a burden to prove that their dues are undisputed, which in turn raises the cost of OCs to initiate CIRP. This process for OCs shall be simplified and made less cumbersome with fast-tracked adjudication to prove whether the dues are in dispute or not, to make the process less time-consuming.
- b. The threshold to initiate CIRP under Section 12 shall be reduced to make it more accessible for OCs who do not meet such high thresholds but have their dues pending from CD to initiate the process for the CIRP.
- c. The OCs, who meet the threshold specified under Section 24 to be eligible for attending meetings of CoC, shall be provided with at least limited voting rights and shall be appointed to be representatives on behalf of all other OCs to voice their concerns in the CoC meetings and have the limited right to vote.
- d. Provisions for reimbursement of administrative expenses for initiation of insolvency proceedings against CD shall be incorporated in IBC, similar to the insolvency code in the USA, to decrease the cost of initiating the insolvency proceedings for OCs and other stakeholders.
- e. Preference shall be given to OCs for satisfaction of their dues in the order prescribed in Section 53, to assist OCs in increasing the amount of recovery of their dues and easing their hardships.
- f. Special provisions shall be made to give preference to small businesses and MSMEs so that their cost of compliance and participation in legal proceedings is reduced,

leading to greater participation of MSMEs in the insolvency proceedings. Additionally, they shall be given an option to recover their dues from other recovery mechanisms, such as those mentioned in the MSMED Act, for quick resolution and satisfaction of their dues.

B. Conclusion

OCs are an important player in the Indian economy, which provides goods and services on credit to businesses. However, these creditors are given a substituted treatment during the insolvency process under the IBC, such as a lengthy process for initiation of CIRP, non-participation of OCs in CoC meetings and last priority during distribution of assets at the time of liquidation. The Courts have also justified the differential treatment given to OCs in various landmark cases, such as *Swiss Ribbons* and *Essar Steel*. Considering all these factors, the OCs have been provided with procedural and substantive injustice. Because of these conditions, MSMEs who are engaged in the provision of goods and services on credit are adversely affected and face difficulties during the insolvency process. Finally, after analysing the U.S. insolvency law, it is clear that trade creditors are better treated under the U.S. Bankruptcy Code than under the IBC, because of various provisions such as a uniform process for initiation of Bankruptcy proceedings, a process for reimbursement of administration fees and return of goods to trade creditors during the bankruptcy proceedings, a place in the committee of creditors and voting rights. Considering all these factors, there are certain improvements needed to be made in the IBC for the betterment of OCs and to provide them with more rights to improve their position in the insolvency process.
