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Comparative analysis of Corporate Insolvency Resolution Process of Financial and Operational Creditor in India

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ABSTRACT

In the dynamic times of increased stressed assets in the country, the Insolvency and Bankruptcy Code, 2016 is in itself is a landmark development and came as a ray of hope for the increase distressed assets and non-tallying assets in the financial system. Furthermore, for running a business of an entity, the supply of goods and services on credit is as significant as financial system, both are parallelly important for functioning of a business. The Insolvency and Bankruptcy Board established the "Corporate Insolvency Resolution Process" in 2016 in response to the surge in NPAs and the lack of a proper method to address the issue. It refers to insolvency proceedings, in which any corporate debtor who defaults in payment can start the process on their own or with the help of a financial creditor or operational creditor. The Insolvency and Bankruptcy Code, 2016, is without a doubt one of the most significant changes to have occurred in the corporate sectors recently, but the code itself distinguishes between financial and operational creditors by restricting the operational creditor ability to participate in meetings, cast votes, and join committees of creditors. Additionally, it restricts the ability of operational creditorsto vote in the committee of creditors, change the appointment or terms and conditions of the corporate debtor's statutory or interim auditors, or any other stated staff, among other things. It also limits the power of operational creditors to have a right over accessing financial details from resolution professionals. This Article emphasizes on how the distinction between financial and operational creditors causes prejudice against operational creditors during the insolvency process by contravening the principles of equality and natural justice as enriched in the constitution.

Keywords: *Corporate Insolvency Resolution Process, Resolution professionals, distressed Assets.*

I. INTRODUCTION

One of the most significant and immediate concerns the nation had to deal prior to the enactment

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of Insolvency and Bankruptcy Code, 2016, was to tackle the problem of insolvency. Although numerous laws passed before to the creation of Insolvency and Bankruptcy Code, 2016 but there was no one-stop solution to the straddled liabilities and increased stressed assets. The Insolvency and Bankruptcy Code, 2016 has significantly changed the scenario of insolvency in India and encouraged corporations to borrow money in a responsible manner. The main goals of the code are to consolidate and amend the laws governing the restructuring and insolvency resolution of corporations, partnership firms, and other legal entities; to provide a time-bound resolution process; to ensure maximization of value of assets; to encourage entrepreneurship; to balance the interests of stakeholders; and to establish IBBI as a regulatory body. Prior to the enactment of the code there were numerous laws in India, and there was a lot of ambiguity over the procedures for various legal entities. The absence of appropriate law to tackle and address the evolving circumstances led to a significant buildup of non-performing assets, and creditors had to wait for years to get their money back. The Insolvency and Bankruptcy Code, 2016 also known as the IBC, is a key reform of Indian capitalism that seeks to enhance how firms declare bankruptcy while promoting more open access to finance. The Insolvency and Bankruptcy Code, 2016 was passed with the primary goal of strengthening the reorganization framework in India by providing creditors greater influence, but on the other hand the code discriminates between secured and unsecured creditors and falls short of upholding their interests. Undoubtedly, the code has been effective in reducing the growing threat of NPAs and has helped the economy in a variety of complex ways by enhancing credit discipline. However, by undermining the principles of equality, the code itself has failed to fulfil its ultimate purpose.

II. INSOLVENCY AND BANKRUPTCY CODE, 2016

(A) History

Insolvency law in India is based on English law. The need for a legal framework to deal with insolvency was first recognized in India's three Presidency towns of Bombay, Calcutta, and Madras, where the British engaged on trade. Sections 23 and 24 of the Government of India Act, 1800, the Indian Insolvency Act, 1848, and the Presidency-towns Insolvency Act, 1909 are the first insolvency regulations. The Presidency-towns Insolvency Act, 1909, is still in effect in Bombay, Calcutta, and Madras, and it governs the insolvency of individuals, partnerships, and groups of individuals. The first insolvency court was formed in the Presidency towns by law enacted in 1828. Basically, these courts were established to assist insolvent debtors. They acted as both individual and record courts. Any person who is dissatisfied with the above-mentioned court's decision may appeal to the Supreme Court. The Supreme Court established the authority

to hear and transfer such types of requests as it deemed fair and substantial, and identical applications or demands are to be deferred through the courts for the mitigation of the insolvent or borrower. Prior to 1907, there was no legislation dealing with insolvency in non-presidency areas. As a result, the Provincial Insolvency Act was passed in 1907, which was eventually replaced by the Provincial Insolvency Act 1920⁴. These two pieces of legislation were in effect until recently, when they were repealed by the IB Code. Bankruptcy and insolvency were defined in the Concurrent List of the 1950-adopted Indian Constitution, whereas the incorporation, regulation, and winding up of corporations fell under the Union List. In 1956, the Parliament passed the Companies Act with this authority. All facets of a company's operation, including its winding up, were covered by this Act. Insolvency and bankruptcy were not defined under the Act, which simply addressed a person's "inability to pay debts." In this Act, which was passed during the earliest stages of India's industrialization drive, Worker and government payments were made a priority over secured creditors' payments. The Companies Act of 1956 included a number of provisions that may be used by the company or its creditors to re-organize it, although these were generic clauses and not specific to instances of insolvency or bankruptcy. Due to legal complications, these could not, however, be communicated. Despite the new regulations, there are still difficulties in implementing the corporate insolvency rules. As a result, the provisions of the Companies Act, of 1956 continue to be in effect. Sick Industrial Companies Act (SICA) was passed in 1985 with the objective of finding out "sickness" in industrial companies and reviving them. The Board of Industrial and Financial Reconstruction (BIFR) and the Appellate Authority for Industrial and Financial Reconstruction were established to support the Act. The SICA was the first statute that was primarily concerned with corporate restructuring. The SICA's main drawback was that it only applied to sick industrial companies, excluding those engaged in trading, service, or other businesses⁵. The RBI has appointed the advisory group on Bankruptcy laws which was established in 2001 and made various recommendations for changes to bankruptcy law and one of those ideas was the consolidation of all the disparate bankruptcy court laws into a distinct code, But nothing was done. The J.J. Irani Committee Report was then established in 2005 with a goal to revise company law in particular and creating a frame work for International Bankruptcy and restructuring procedures.

⁴ 7 Anjali Krishna, A historical evaluation of Insolvency and Bankruptcy laws in India, LawBhoomi, (Jun. 19, 2023, 02:55 PM), <https://lawbhoomi.com/a-historical-evaluation-of-insolvency-and-bankruptcy-laws-in-india/>

⁵ 8 Harshal Sadhwani, The Indian Bankruptcy Laws and how are they different from UK and US, Legal Service India E-Journal, (Jun. 19, 2023, 03:11 PM), <https://www.legalserviceindia.com/legal/article-3356-the-indian-bankruptcylaws-and-how-are-they-different-from-uk-and-us.html#>

The Committee has suggested that the statute should be modified to speed up the restructuring and liquidation procedure where in by creating a unified framework for addressing corporate insolvency through a specialized adjudicatory authority. In 2014, the Ministry of Finance established the Bankruptcy Law Reforms Committee (BLRC), which is chaired by Dr. T. K Viswanathan, to fight for comprehensive bankruptcy reform. The report of this committee was divided into two parts: the first dealt with including logic and design/recommendations, and the second was a comprehensive draft Insolvency and Bankruptcy Bill covering all companies. The major recommendations of the Report are the Insolvency Regulator and Insolvency Adjudicating Authority⁶.

In December 2015, the Insolvency and Bankruptcy Code, 2016, was introduced in Lok Sabha. The law came into force in December 2016. A Notification was passed by the national company law tribunal under SICA (special provisions) repeal act 2003. Therefore, the SICA is repealed with effect from 1 December 2016.

III. CORPORATE INSOLVENCY RESOLUTION PROCESS

Corporate insolvency resolution process is a recovery mechanism through which the creditors can recover their debts in case the corporate entity turns insolvent. Where any corporate debtor commits a default, a financial creditor, an operational creditor, or the corporate debtor itself may initiate corporate insolvency resolution process in respect of the corporate debtor⁷.

The following below are eligible to initiate Corporate Insolvency Resolution process as mentioned below:

(A) Financial Creditor

Financial creditor is a person to whom a financial debt is due besides an assignee or transferee from such person⁸. A financial creditor either by itself or jointly with other financial creditors may file an application for initiating corporate insolvency and resolution process before an adjudicating authority when a default has occurred⁹.

(B) Operational Creditor

An operational creditor is a person to whom operational debt is owed, and includes any person to whom such debt has been legally assigned and transferred¹⁰. The operational creditor is

⁶ BHATT & JOSHI ASSOCIATES, <https://bhattandjoshiassociates.com/the-insolvency-and-bankruptcy-code-2016/>, (last visited Jun. 19, 2023).

⁷ The Insolvency and Bankruptcy Code 2016, Sec 6, No.31, Acts of Parliament,2016 (India).

⁸ The Insolvency and Bankruptcy Code 2016, Sec 5(7), No.31, Acts of Parliament,2016 (India).

⁹ The Insolvency and Bankruptcy Code 2016, Sec 7(1), No.31, Acts of Parliament,2016 (India).

¹⁰ The Insolvency and Bankruptcy Code 2016, Sec 5(20), No.31, Acts of Parliament,2016 (India)

eligible to initiate insolvency resolution process when any corporate debtor defaulted in payment of any goods and services given by the creditor.

(C) Corporate Debtor

A corporate debtor is any person that owes a debt to another¹¹. The corporate debtor is eligible to initiate corporate insolvency resolution process by filing an application to Adjudicating Authority¹².

IV. CORPORATE INSOLVENCY RESOLUTION PROCESS BY OPERATIONAL AND FINANCIAL CREDITORS IN INDIA

1) By an operational creditor

The Operational Creditor can initiate Corporate Insolvency Resolution process when a corporate debtor who can be an individual or a corporation who owed operational debt. Operational debt is basically a claim for the goods and services including employment a debt for repayment of dues payable to any local authority or State Government or Central Government¹³.

So, when a corporate debtor defaults in payment of operational debt then the operational creditor itself may initiate CIRP. The Corporate Insolvency Resolution Process is mentioned in below following stages.

a. Issuance of notice by an operational creditor

The Operational Creditor before filing the application for CIRP must serve a demand notice or a copy of invoice demanding payment of the default amount to the corporate debtor¹⁴. The corporate debtor shall within 10 days of receiving of demand notice bring to the notice of Operational creditor if there is existence of any dispute of any pendency of suit or arbitration and by sending any attested copy of electronic record of the unpaid amount.

2) By financial creditor:

When a default has taken place, a financial creditor may apply to the adjudicating authority to begin a corporate insolvency resolution process against a corporate debtor, either individually or collectively with other financial creditors¹⁵.

¹¹ The Insolvency and Bankruptcy Code 2016, Sec 3(8), No.31, Acts of Parliament,2016 (India).

¹² The Insolvency and Bankruptcy Code 2016, Sec 10, No.31, Acts of Parliament,2016 (India).

¹³ The Insolvency and Bankruptcy Code 2016, Sec 5(21), No.31, Acts of Parliament,2016 (India).

¹⁴ The Insolvency and Bankruptcy Code 2016, Sec 8, No.31, Acts of Parliament,2016 (India).

¹⁵ The Insolvency and Bankruptcy Code 2016, Sec 7, No.31, Acts of Parliament,2016 (India).

Stage 1: Application for Initiation of Corporate Insolvency Resolution Process:

- a. **By an operational creditor:** After the expiry of the 10 days period from date of delivery of notice and if the operational creditor does not receive receipt of payment or notice of dispute he can file an application for initiation of corporate insolvency resolution process. The operational creditor shall furnish a copy of demand notice, an affidavit to effect that there is no notice given by corporate debtor relating to dispute of unpaid operational debt, a copy of the certificate from financial institution confirming there is unpaid operational debt. The operational creditor along with furnishing the above information may also propose interim resolution professional.
- b. **By a financial creditor:** A Financial creditor along with the filing of application shall also furnish a record of default recorded in the information utility or such other evidence of default, the name of resolution professional proposed, any other information as may be specified by board¹⁶.

Stage 2: Acceptance or Rejection of Application

The Adjudicating Authority shall within fourteen days of the receipt of the application shall communicate its decision:

- a. **For operational creditor:**
 - **Admit the application:** If the Adjudication Authority is of the opinion that the application is complete, there is no repayment of unpaid operational debt , invoice or notice is delivered , no notice of any dispute has been received and there is no disciplinary proceedings pending against resolution professional.
 - **Reject the application:** if the Adjudication Authority is of the opinion that the application is not complete, there has been repayment of unpaid operational debt, the creditor has not delivered the invoice, notice of any dispute has been received and there presence of any disciplinary proceedings pending against resolution professional. The Adjudicating Authority shall before rejecting the application give notice to the applicant to rectify defect in seven days of the date of receipt of such notice.

¹⁶ The Insolvency and Bankruptcy Code 2016, Sec 7(3), No.31, Acts of Parliament,2016 (India).

b. For financial creditor¹⁷:

- **Admit the application:** if the Adjudicating Authority is of the opinion that a default has occurred and their absence of disciplinary proceedings pending against proposed resolution professional it may by order admit the application.
- **Reject the application:** if the adjudicating Authority is of the opinion that the application is incomplete and there is a presence of disciplinary proceedings against the proposed resolution professional, it may by order reject the application. Furthermore, the Adjudicating Authority before rejecting application, give a notice to the applicant to rectify the defect within seven days of receipt of such notice by the authority.

Stage 3: Commencement Of Cirp

The corporate insolvency resolution process shall be commenced from the date of application, and the procedure should be completed within one hundred and eighty days from date of admission of the application. The resolution professional shall file an application for the extension of process if instructed by Committee of creditors by sixty-six of voting share¹⁸. The resolution procedure should be completed within three hundred and thirty days failing which Adjudicating Authority shall initiate liquidation.

Stage 4: Declaration Of Order Of Moratorium And Public Announcement

The Adjudicating Authority immediately after accepting the application for corporate insolvency resolution process shall by order declare moratorium, appoint an interim resolution professional and he shall immediately after his appointment should make the public announcement¹⁹.

The Adjudication Authority by order declare moratorium for prohibiting the institution of suits or continuation of proceedings of judgement or decree or order in any court of law, tribunal, arbitration or other authority, transferring, encumbering, alienating or transferrin any asset any action to foreclose, recover or enforce any security created under SARFASI Act, 2002, recovery on any property by an owner or lessor occupied or in possession of corporate debtor.

Where the interim resolution professional is of the opinion that supply of goods and services are critical to preserve and protect the value of corporate debtor then such supply shall not be

¹⁷ The Insolvency and Bankruptcy Code 2016, Sec 7(5), No.31, Acts of Parliament,2016 (India).

¹⁸ The Insolvency and Bankruptcy Code 2016, Sec 12, No.31, Acts of Parliament,2016 (India).

¹⁹ The Insolvency and Bankruptcy Code 2016, Sec 13, No.31, Acts of Parliament,2016 (India)

terminated, suspended or interrupted.

The objective of the moratorium is to form a shield the corporate debtor from pecuniary attacks against it in the moratorium period so that the corporate debtor breathing space to continue as a going concern to ultimately rehabilitate itself. So this process helps by defending the parallel proceeding's and helps in maximizing the value of company²⁰.

The public announcement must contain the names and addresses of corporate debtor name of authority under which the corporate debtor is incorporated, last date of submission of claims and the date at which CIRP proceedings be closed. The public announcement shall be published in English or regional newspaper, on the website of the corporate debtor if any, on the website if any as designated by the board.

Stage 5: Appointment Of Insolvency Resolution Professional

The Adjudicating Authority will appoint the interim resolution professional as proposed by the operational creditor if there is absence of any disciplinary proceedings against the proposed. If the operational creditor did not propose any interim resolution professional, then reference is made the board for recommendation. The board within 10 days of receipt of reference recommend the interim resolution professional to the adjudicating authority²¹.

From the date of appointment of interim resolution professional should manage the affairs of the corporate debtor, has the powers to board of directors or partners of corporate debtor access documents and records of corporate debtor, maintain the accounts of corporate debtor, shall act on behalf of corporate debtor for all deeds, receipts and documents²².

Stage 6: Constitution Of Committee Of Creditors

The interim resolution shall after collation of claims and after the determination of financial position shall constitute committee of creditors. The committee of creditors shall include all financial creditors. In a case where a person is a creditor of both financial and operational debt then the person shall be a financial creditor till the extent of financial debt. The first meeting shall be constituted after the commencement of committee of creditors. Before filing an application for replacement of interim resolution professional the committee of creditors by sixty six percent of voting shall decide on appointment of Resolution professional²³.

²⁰ Alchemist Asset Reconstruction Company Limited Vs. Hotel Gaudavan Private Limited,(2018) 16 SCC94

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

²² The Insolvency and Bankruptcy Code 2016, Sec 17, No.31, Acts of Parliament,2016 (India).

²³ The Insolvency and Bankruptcy Code 2016, Sec 22, No.31, Acts of Parliament,2016 (India).

Stage 7: Preparation Of Information Memorandum

The resolution professional shall prepare an information memorandum containing relevant information for the formulation of resolution plan. Furthermore, the Resolution Professional shall provide to resolution applicant access to all approval of committee. The Resolution applicant shall be given access to all relevant information required to make resolution plan for corporate debtor including financial position, disputes by or against corporate debtor in physical and electronic form to comply the confidentiality and insider trading, protect corporate debtor's Intellectual property, and not to share the relevant information with the third party.

Stage 8: Submission Of Resolution Plan By Resolution Applicant

Basing on the relevant information provided by the Resolution Professional the resolution applicant may submit a resolution plan which shall include costs for the insolvency resolution process, provide for repayment of debt of operational creditor which shall not be less than the amount to be paid to the operational creditors in the event of a liquidation of the corporate debtor, management of affairs of corporate debtor, implementation and supervision of resolution plan, conforms to the requirements of board and shall not contravene the IBC,2016. The resolution professional after confirming the resolution plan shall present it to the committee of creditors. the resolution plan may be approved of voting share not less than seventy five percent by the financial creditors. After the approval of Committee of creditors, the resolution professional shall submit the resolution plan to the Adjudicating Authority.

Stage 9: Approval/Rejection By Adjudicating Authority

The Adjudicating Authority if satisfied after meeting the requirements of the resolution plan it shall by order approve the plan and shall be binding on the corporate debtor, members, creditors, guarantors and other stakeholders. After the order of approval the moratorium order shall cease to have effect and the resolution professional shall forward all records resolution process to the resolution plan submit it to the board in a data base. If the Adjudicating Authority views that the resolution plan does not meet the requirements it may by order reject the plan²⁴.

V. INITIATION OF LIQUIDATION

The entire procedure of bringing a lawful end to the life of a company can be divided into the liquidation process followed by dissolution of corporate debtor. After which property is administered by the liquidator for the benefit of creditors, members and other stakeholders and in this process the debt will be repaid by selling of the assets.

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

(A) Grounds For Initiating Liquidation:

- 1) Resolution plan is not received during CIRP
- 2) Resolution plan rejected by the Adjudicating Authority
- 3) Resolution plan not approved by COC during CIRP
- 4) Resolution plan approved by adjudicating authority is contravened by corporate debtor can make application for liquidation²⁵.

(B) Distinction Between Cirp By Operational And Financial Creditors

- **Operational Debt:** it is a claim in respect of provision of goods or services including employment or a debt in respect of the repayment of dues.
- **Financial Debt:** it means a debt along with interest, which is disbursed against the consideration for the time value of money.

(C) Initiation Of Corporate Insolvency Resolution Process:

- **Operational Creditor:** On occurrence of a default the operational may deliver a demand notice of unpaid operational debt, a copy of invoice demanding amount in default. The operational creditor may file an application after expiry of 10 days from date of delivery of the notice only when there is absence of dispute or non- payment of operational debt.
- **Financial Creditor:** Upon the occurrence of a default, a financial creditor may apply to the adjudicating authority to begin a corporate insolvency resolution process against a corporate debtor, either individually or collectively with other financial creditors.

(D) Appointment Of Interim Resolution Professional

- **Operational Creditor:** may propose a resolution professional to act as interim resolution professional.
- **Financial Creditor:** shall along with application furnish the name of the resolution professional proposed to act as interim resolution professional.

(E) Constitution Of Committee Of Creditors:

- **Operational Creditor:** shall not be part of committee of creditors.

²⁵ The Insolvency and Bankruptcy Code 2016, Sec 33, No.31, Acts of Parliament,2016 (India).

- **Financial Creditor:** The committee of creditors shall consist of financial creditors of the corporate debtor.

(F) Voting Rights:

- **Operational Creditor:** do not have any voting rights at the meeting of committee of creditors.
- **Financial Creditor:** have the right to vote as per the proportion of financial debt in the meeting of committee of creditors.

VI. DISCRIMINATION OF OPERATIONAL CREDITORS U/S 21 OF IBC, 2016

The code clearly mentions that the committee of creditors shall comprise all financial creditors. Furthermore, where a person is both financial and operational creditor such person shall be a financial creditor to the extent of his financial debt and shall be included in the committee of creditors with voting share proportionate to the extent of financial debts owed to such creditors. If the total dues of operational creditor are ten percent or more of the debt then they are permitted to attend the meeting of committee of creditors but not allowed to participate or vote²⁶.

Where the committee of creditors are only operational creditors, in a case where corporate debtor owes no financial debt then such committee shall comprise members as mentioned below:

- i. Eighteen largest operational creditors by value and in the absence of eighteen operational creditors then the committee shall include all such operational creditors;
- ii. One representative elected by all the workmen;
- iii. One representative elected by all the employees.

The voting rights of the members shall be in proportion of debt due to such creditor. And the members of the committee shall have the same rights, powers, duties and obligations as a committee comprising of financial creditors and its members²⁷.

The powers vested on financial creditors under section 21 of the code is broad enough to discriminate against operation creditor because:

1. The members of Committee of creditors have the right to vote at the meetings

²⁶ The Insolvency and Bankruptcy Code 2016, Sec 24(4), No.31, Acts of Parliament,2016 (India)

²⁷ INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (INSOLVENCY RESOLUTION PROCESS FOR CORPORATE PERSONS)) REGULATIONS,2016, Sec 16, Vide Notification No. IBBI/2016-17/GN/REG004, dated 30th November, 2016 (India)

depending on the voting share of financial debt.

2. The approval of Committee of creditors with voting share of 66 percent shall be taken for the following below²⁸:
 - i. To collect excess interim finance in excess of the sum agreed at the CoC meeting.
 - ii. To provide interests as a form of protection over the properties of the Corporate Debtor.
 - iii. Where the corporate debtor is a corporation, to restructure the resources of the corporate debtor by buybacks, the issuance of new classes of securities or additional securities or the redemption of securities already issued.
 - iv. To keep track of the improvements the corporate debtor has made in terms of ownership.
 - v. To conduct related party transactions and issue guidance to the corporate debtor's financial institutions in the event of a debit transition in excess of the agreed-upon volume.
 - vi. To make adjustments to the corporate debtors' Board of Management and Administration, as well as modifications to the corporate debtors' or subsidiaries' constitutional nature of instruments.
 - vii. To assign financial or operating debts, as well as rights under material contracts, to someone other than in the ordinary course of business.
 - viii. Change the appointment or terms and conditions of the corporate debtor's statutory or interim auditors, or any other stated staff.
3. The committee of creditors will vote on and approve the Repayments plan.
4. The committee of creditors of not less than 66 percent of total voting may appoint or substitute the interim resolution professional²⁹.
5. The committee of creditors shall have the right to require any financial information in relation to corporate debtor from the resolution professional.
6. The CoC has the right to provide some financial details to the RP (Resolution Professional) during the CIRP procedure, as long as the information is specifically

²⁸ The Insolvency and Bankruptcy Code 2016, Sec 28(1), No.31, Acts of Parliament,2016 (India).

²⁹ The Insolvency and Bankruptcy Code 2016, Sec 22(2), No.31, Acts of Parliament,2016 (India).

relevant to the corporate debtor.

It is explicit from the above that an operational creditor is discriminated and he cannot be part of committee of creditors and does not enjoy any voting rights and hence limits its representation by violating the principles of equality and right to carry any occupation, trade or business.

VII. ANALYSIS ON PRECEDENTS LAID DOWN BY SUPREME COURT ON THE POSITION OF OPERATIONAL CREDITORS

1. Swiss Ribbons Private Limited and Another Vs. Union of India and Others³⁰.

In this case the Supreme Court held that, it is evident from a comparison of the terms "financial creditor" and "financial debt" that a financial debt includes any interest that is paid in exchange for the consideration of time worth of money. In addition, as section 5(8) offers an inclusive definition, money that is borrowed or raised in any of the ways listed in that section may also qualify. On the other hand, a demand for the provision of goods or services, including employment, or a debt in relation to the payment of dues arising under any law and owed to the government or any local authority would both be considered "operational debts.

" The court further noted that most Operational Creditors, including payments for goods and services as well as payments to employees who are not covered by mortgaged documents and the like, are unsecured in contrast to most Financial Creditors, including banks and financial institutions.

Additionally, the nature of loan agreements with financial creditor's and contracts with Operational creditors for the provision of products and services are different. Term loans or working capital are the two types of financing that financial creditors typically provide to corporate debtors to help them launch or run their businesses. Contrarily, agreements with Operational creditor's deal with the provision of goods and services necessary for the running of the business. Large sums of money are typically involved in financial contracts. Conversely, operational contracts typically have lesser dues. OCs can be more numerous than FCs in the management of a business.

Additionally, Financial creditors have established repayment schedules, and defaults give financial creditor the right to completely recall a loan. Such conditions are not included in contracts with Operational Creditors. Additionally, the place for dispute settlement is totally different. Contracts with OCs can and frequently do include arbitration clauses that provide for confidential dispute settlement.

³⁰ Swiss Ribbons Private Limited and Another Vs. Union of India and Others,(2019) 4 SCC 17.

The court concluded that it is crucial that FCs are involved in determining the feasibility of the corporate debtor right away. When there is financial strain, they can and do restructure the loan as well as the corporate debtor's operations. These are actions that operational creditors are unable or unwilling to take. The IBC must therefore make a distinction between financial creditors and operational creditors in order to maintain the corporate debtor as a going concern while ensuring optimum recovery for all creditors. The distinction is closely connected to the goals of the IBC.

2. Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Others³¹.

In this case the Supreme Court ruled that the concept of "equality" should not be construed to require that all creditors be granted an equal recovery under a settlement agreement. Operating creditors were intended to be a separate class of creditors under the IBC, the Supreme Court emphasized. Additionally, various safeguards were added to the IBC to guarantee equal and 25 (2020) 8 SCC 531. 20 equitable handling of operational creditors' debts, including priority in debt recovery and mandatory notification of the treatment of operational creditors' interests in resolution plans. Additionally, the court ruled that differentiated treatment depending on the value of a class of secured financial creditors' security would be acceptable.

The Court noted that many creditors would be encouraged to vote for liquidation rather than settlement if the security interests of the creditors were ignored during the CIRP. The Court emphasized that the IBC itself considers operational creditors as a separate class of creditors and that financial creditors and operational creditors cannot ever be ranked equally because of their commercial relationships with the corporate debtor.

To ensure the fair and equitable handling of such operational creditors' interests, the IBC offers a number of protections such as priority in repayment. The Supreme Court concluded that the CoC could approve and even negotiate for a resolution plan that provided for differential payment to financial and operational creditors as long as the IBC's requirements were met.

VIII. JUSTIFICATION BY BLRC ON THE POSITION OF OPERATIONAL CREDITOR

The Banking Law Reforms Committee's report supports the drafter's intention to protect stakeholders by emphasizing firm revival before asset liquidation if it fails. Therefore, it is evident that the committee is working to restructure and revive the business, but if those efforts are unsuccessful, section 53 of the Insolvency and Bankruptcy Code, 2016, will force the

³¹ Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Others (2020) 8 SCC 531.

liquidation of assets, and the proceeds will be distributed according to the following priority order: costs associated with the insolvency resolution and liquidation, relinquished secured creditors, unpaid workmen's compensation, and unpaid dues and later to the unsecured creditors etc³². In the majority of the time the liquidation value completely depletes while paying for the costs of insolvency proceedings and liquidation costs, relinquished financial creditors and other groups ranking higher in order, the operational creditor receives less or no payment at the conclusion, the order of prioritization discriminates against them compared to financial creditors. As per the insolvency law in United Kingdom is concerned the law does not stipulate the difference between financial and operational creditors. Additionally, all the creditors form a part of committee of creditors in the ratio of debt unlike India where operational creditor are not part of committee of creditors.

IX. RECOMMENDATIONS

1) Section 21 of the code discriminates and restricts the privileges of operational creditor: to vote in the meeting of committee of creditors, change the appointment or terms and conditions of the corporate debtor's statutory or interim auditors, or any other stated staff, among other things. It also limits the power of operational creditors to have a right over accessing financial details from resolution professionals etc. Due to his inability to join the CoC and the reality that he is not granted any of the privileges mentioned above, it is therefore abundantly clear that an operational creditor is being discriminated and contravenes the principles of equality.

2) The sequence of prioritization as mentioned u/s 53 is the sequence of discrimination of operational creditor over financial creditor: For effective functioning of business supply of goods and services are as important as financial arrangement. But this section 53 of the code places relinquished secured creditor at second footing whereas the secured creditor is placed at fourth footing. In most of the cases the liquidation value completely gets depleted while paying financial creditor and other groups ranking high in order resulting in no payment to the operational creditor. Therefore, it is suggested from the above for the prevention of equality and delivery of justice there shouldn't be any distinction between the class of creditors. All the financial creditors should be treated as par with the operational creditors because every creditor's ultimate objective is to maximize recovery and the code should provide a mechanism

³² Sudip Mahapatra, Misha Chandna and Pooja Singhania, Operational Creditors In Insolvency: A Tale Of Disenfranchisement, S&R ASSOCIATES, (Jun. 20, 2023, 11:19 AM) <https://www.mondaq.com/india/insolvencybankruptcy/971940/operational-creditors-in-insolvency-a-tale-of-disenfranchisement>

to promote and prioritize the interests of secured and unsecured creditors. Additionally, any recovery above liquidation value of the secured assets like the residual debt should be proportionally be paid amongst the remaining creditors.

X. CONCLUSION

For a society governed by rule of law the principle of natural justice is significant to ensure fairness and to protect justice. One of the principles of natural justice “Nemo debet esse iudex in propria causa” is a Latin term meaning “no one can be a judge in his own case”. But the very code restricts the operational creditor and allows financial creditor to be part of committee of creditors. Although the objective of committee of creditors is to maximize the value of assets of corporate debtor, the ability of committee of creditors to select, negotiate and approve the successful resolution plan renders administrative powers that may provide the opportunity to influence Resolution Applicant to submit a resolution plan that maximizes the value of members of CoC and not necessarily maximize the value of corporate debtor. Therefore, the differentiation between operational and financial creditors leads to discrimination by contravening the principles of natural justice and Equality enshrined in the Constitution.
