Page 76 - 82 **DOI:** *https://doij.org/10.10000/IJLMH.118892*

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 8 | Issue 1

2025

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The IBC, 2016: A Framework for Balancing Competing Interests in Insolvency Proceedings

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ABSTRACT

The corporate structure has many stakeholders, including suppliers, investors, creditors, and shareholders. It can be challenging to balance the interests of parties involved in procedures regulated by laws, such as bankruptcy or corporate governance. Legal frameworks, like the Insolvency and Bankruptcy Code, 2016 (IBC), are intended to balance the conflicting interests of many stakeholders, including creditors, employees, shareholders, and other interested parties while maintaining justice and transparency. Every stakeholder group has different priorities i.e. creditors emphasize debt collection, shareholders aim to maximize profits, and employees value job security. Legal codes offer a methodical approach that guarantees the systematic consideration of stakeholder interests.

The challenge lies in balancing these divergent interests while upholding the sustainability, efficiency, and equality standards. Legal procedures must balance current claims with long-term sustainability to prevent any party from becoming unduly privileged. This often involves discussions, strategic decision-making, and adherence to regulatory rules, such as creditor committees or shareholder rights, to prevent the domination of more powerful stakeholders. Stakeholder management is dynamic and complicated due to the effect of the wider economic and regulatory environment on these activities. This short article examines case studies in corporate governance and bankruptcy scenarios to investigate the mechanisms within legal codes. It also emphasizes the significance of judicial monitoring, regulatory agencies, and transparent communication to achieve fair results that safeguard the interests of all parties concerned.

Keywords*: Corporate Governance, Stakeholder Management, Insolvency and Bankruptcy Code (IBC), Equitable Treatment.*

I. INTRODUCTION

The development of India's bankruptcy and insolvency laws shows a dynamic transition from obsolete legal frameworks to a contemporary, unified system that places a high priority on

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effective debt settlement and stakeholder interest protection. To assist insolvent debtors in presidential cities, special insolvency courts were established in 1828 under Act 9 marking the beginning of insolvency laws in India. The Supreme Court dealt with appeals from these courts, which functioned as courts of record. However, the deficiencies of the system led to further reforms. While still being supervised by the Supreme Court, the Indian Insolvency Act, of 1848, superseded previous laws and expanded the scope of insolvency regulations to include both merchants and non-merchants. Despite being a step forward, this Act quickly became outdated due to its inefficiencies in addressing creditor concerns and modern commercial realities.

The English Bankruptcy Acts of 1883 and 1890 served as the model for the Presidency-Towns Insolvency Act of 1909. The foundation for more extensive legislative measures was laid in the Indian Constitution of 1950, which acknowledged the persistent difficulties by placing the topics of "insolvency" and "bankruptcy" in the Concurrent List under Schedule 7 and company incorporation and liquidation in the Union List.[3]

The Companies Act of 1956, which consolidated laws of the operation and dissolution of corporations, was a major turning point in corporate law. Although it established procedures for reorganizing financially troubled businesses, it lacked explicit bankruptcy and insolvency clauses. The Sick Industrial Companies Act (SICA) was first introduced in 1985 to help financially troubled businesses get back on their feet. However, SICA's restricted scope, lengthy resolution timetables, and organizational inefficiencies caused it to collapse. Dr. T.K. Viswanathan established the Bankruptcy Law Reforms Committee (BLRC) in 2014 to put up a thorough insolvency framework. To unify disparate legislation and implement a time-bound resolution process, the BLRC suggested creating a single Insolvency and Bankruptcy Code (IBC). With the implementation of the IBC in 2016, India's bankruptcy environment underwent a radical change. In addition to designating the National Company Law Tribunal (NCLT) and Debt Recovery Tribunals (DRTs) as adjudicating bodies, it established a strong institutional structure that included the Insolvency and Bankruptcy Board of India (IBBI) as a regulatory agency.

II. Importance of balancing the stakeholder's interest in insolvency proceedings

The Insolvency and Bankruptcy Code, 2016 (IBC) seeks to provide an unified framework to address insolvency and bankruptcy while prioritizing the interests of all stakeholders. A critical objective of the IBC is to balance the diverse interests of stakeholders involved in the insolvency

[3] Hritika Sharma, *Evolution of the Insolvency and Bankruptcy Laws in India*, IBC Laws (2020)

resolution process. The Resolution Professional (RP) is a key person in this structure, responsible for providing fair and effective management while balancing the competing interests of the numerous parties participating in the Corporate Insolvency Resolution Process (CIRP). These stakeholders include financial creditors (FCs), operational creditors (OCs), secured and unsecured creditors, equity owners, government authorities, workers and other claims.

Striking a balance among stakeholders is both a legal and practical necessity. The Code ensures equitable treatment through provisions like *Section 30(2)(b),* which guarantees that operational creditors (OCs) receive at least what they would in a liquidation scenario, and *Section 53,* which outlines the priority order for distributing liquidation proceeds. The IBC strives to achieve a delicate balance between competing claims, fostering confidence in the insolvency process while maintaining economic efficiency. This balance is pivotal to encouraging resolution over liquidation, protecting all stakeholder interests, and sustaining corporate debtors as going concerns, thereby preserving organizational and economic value.

III. CLASSIFICATION OF STAKEHOLDERS

1. Creditors

The IBC, 2016 distinguishes between financial creditors and operational creditors, each with its own set of duties, rights, and obligations.

(A) Financial Creditors

According to **Sections 5(7) and 5(8)** of the IBC, financial creditors are organizations whose connection to the debtor results from a financial contract, such as a loan or financial instrument.

a. Rights of financial creditors:

- **Representation in the Committee of Creditors (CoC):** Financial creditors form the CoC, which is the decision-making body during CIRP. According to **Section 21**, only financial creditors are members of the CoC, granting them significant influence in determining the resolution or liquidation of the corporate debtor.
- **Voting Rights:** As per **Section 30(4),** financial creditors have voting rights proportional to the value of their claims. A resolution plan requires approval by at least 66% of the voting share in the CoC to be implemented.
- **Priority in Distribution:** During liquidation, under **Section 53**, financial creditors are prioritized in the distribution of proceeds after meeting the costs of CIRP. Secured financial creditors have the highest claim after insolvency resolution costs and employee

dues.

b. **Judicial Clarifications:** In ***Swiss Ribbons Pvt. Ltd. v. Union of India***[4]**,** the apex court maintained the CoC's exclusive right to decide on resolution plans, emphasizing its creditor-centric framework. The Court highlighted that financial creditors possess better expertise in assessing the viability of resolution plans.

(B) Operational Creditors

According to **Sections 5(20) and 5(21)** of the IBC, operational creditors are organizations that owe money for products or services, such as employment or statutory obligations payable to government agencies.

a. Rights of operational creditors:

- **Limited Representation in CIRP:** Unlike financial creditors, operational creditors do not form part of the CoC. However, under **Section 24**, they may be invited to CoC meetings if their aggregate dues constitute a significant proportion of the total debt.
- **Payment Protection:** A resolution plan must include provisions for paying operational creditors' debts, at least as much as they would have received during liquidation, in accordance with **Sec 30(2)(b).**
- **Priority in Liquidation:** During liquidation process, operational creditors rank below secured and unsecured financial creditors but above shareholders in the distribution waterfall under **Section 53**.

b. Judicial Clarifications:

In ***Innoventive Industries Ltd. v. ICICI Bank*****,**[5] the Supreme Court clarified the distinction between financial and operational creditors, emphasizing that operational creditors lack the ability to assess resolution plans comprehensively. However, cases like ***JSW Steel Ltd. v. Mahender Kumar Khandelwal***[6] have highlighted the need to safeguard their interests in payment distributions.

2. Corporate Debtors

Any business entity that owes money to another is considered as a corporate debtor under Section 3(8) of the IBC, 2016 framework in India. A limited liability partnership (LLP), corporation, or any other individual incorporated with limited responsibility under any

[4] (2019) 4 SCC 17, decided on January 25, 2019.
[5] Innoventive Indus. Ltd. v. ICICI Bank, (2018) 1 SCC 407 (India)
[6] JSW Steel Ltd. v. Mahender Kumar Khandelwal, (2020) 12 SCC 599 (India)

legislation is included in this.

(A) Employees and vendors

Employees and vendors are categorized as operational creditors under the IBC,2016.

Employees - Employees are individuals who provide services to the corporate debtor under an employment agreement and are owed wages, salaries, or other benefits.

Relevant Provisions:

- **Section 5(20):** Employees to whom operational obligations are owed are defined as operational creditors under Section 5(20).
- **Section 5(21):** According to Section 5(21), an operational debt is a demand for wages, salaries, or other amounts owed to workers or employees.
- **Section 53:** Prioritizes the payment of employee dues during the liquidation process, ranking after insolvency resolution process costs and secured creditors but before unsecured financial creditors.

Vendors - Vendors are companies or people that provide the corporate debtor with goods or services. According to the Code, their claims are classified as operational debts.

Relevant Provisions:

- **Section 5(20) and 5(21):** Include vendors as operational creditors if they are owed debts for goods supplied or services rendered.
- **Section 9:** If the default surpasses ₹1 crore (as per the modified threshold), it gives operational creditors including vendors the ability to start a CIRP against the corporate debtor.

3. Government and regulatory bodies

If the corporate debtor owes taxes, tariffs, or other regulatory costs, the government is considered a creditor under the IBC. Their claim is higher than that of equity owners but lower than that of workers and financial creditors. Government dues include Income tax, GST, Customs and Excise Duties, Stamp Duties and other statutory levies.

Regulatory authorities such as the SEBI and sector-specific regulators ensure compliance with regulations. Regarding violations of regulations, they might impose fines or penalties. The exchequer frequently recovers less when government dues are given less attention.

IV. Challenges in balancing stakeholder's interests

Balancing stakeholders' interests under the IBC are a critical challenge.

1. Issues in Operational Versus Financial Creditor Rights

- **Priority in Claims:** Under IBC, financial creditors are granted significant precedence over operational creditors in decision-making through the Committee of Creditors (CoC). Operational creditors, despite being critical for the day-to-day functioning of a company, often find their claims ranked lower in the resolution hierarchy, leading to lower recovery rates.
- **Voting Rights:** Operational creditors lack voting rights in the CoC unless their dues exceed 10% of the total debt. This limits their ability to influence key decisions during the resolution process, which is often perceived as inequitable.
- **Legal and Practical Concerns:** Financial creditors are typically secured and have access to better legal remedies, whereas operational creditors (e.g., suppliers, and service providers) are unsecured. This disparity creates an imbalance, potentially discouraging smaller creditors from participating actively in the insolvency process.[7]

2. Role of the Committee of Creditors (CoC) and Potential Biases

- **Dominance of Financial Creditors:** The CoC comprises primarily financial creditors, who prioritize maximizing their recoveries. This focus can overshadow other interests, such as operational creditors or the viability of the corporate debtor as a going concern.
- **Potential Conflicts of Interest:** Large financial institutions often have extensive legal and financial resources to shape resolutions in their favour, potentially sidelining smaller creditors or less influential stakeholders.
- **Bias Toward Liquidation:** Financial creditors may sometimes prefer liquidation over resolution if it results in faster recoveries, disregarding the long-term sustainability of the corporate debtor and the broader economic impact.

3. Treatment of Employees and Minority Shareholders

- **Low Priority in Claims:** Employees' unpaid dues are treated as operational debt, often leading to minimal recovery. While some protection exists under Section 53 of IBC, the amounts recovered typically fall short of expectations.

[7] Jha, Amit. "Operational Creditors and Financial Creditors: A Critical Analysis under IBC." *Indian Journal of Corporate Law Studies,* 2020.

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- **Dilution of Interests:** Resolution plans frequently involve a significant dilution of equity, leaving minority shareholders with negligible or no stake in the restructured company.
- **Exclusion from Decision-Making:** Shareholders, especially minority ones, generally have no voting rights in the insolvency process, effectively excluding them from influencing outcomes.

4. Regulatory Delays and Procedural Inefficiencies

- **Judicial Backlogs:** The NCLT and the NCLAT are often overburdened with cases, leading to significant delays in resolution timelines.
- **Extended Timelines:** Despite the stipulated 330-day limit under IBC, delays due to procedural inefficiencies, litigations, and multiple appeals often result in prolonged uncertainty for stakeholders.

V. Conclusion

The Insolvency and Bankruptcy Code (IBC) was introduced to create a more efficient and timely approach to handling insolvencies, boosting economic value, and balancing the interests of different stakeholders. While it has made significant progress, such as improving recovery rates and speeding up processes, there are still challenges to overcome. The fast-evolving nature of the economy, complex corporate structures, and shifting expectations from stakeholders call for continuous updates and improvements. To keep the IBC effective in balancing the interests of all parties, it's crucial to develop a robust system that integrates legal, economic, and social considerations. This involves streamlining judicial procedures, tackling operational challenges, and ensuring fair treatment for creditors, employees, and other involved parties. Effective policy measures and a focus on protecting the rights of creditors while supporting the sustainability of debtors are key to strengthening the IBC.

Ultimately, striking a balance under the IBC is a continuous process that calls for flexibility, inclusivity, and response to the shifting economic landscape.

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