IV. REVISITING THE STATUS OF OPERATIONAL CREDITORS UNDER THE INDIAN INSOLVENCY REGIME - NEED FOR A PARADIGM SHIFT

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ABSTRACT

The treatment of Operational Creditors under the Insolvency and Bankruptcy Code, 2016 ("Code") has been a contentious subject ever since its inception. The composition of the Committee of Creditors ("CoC") and the hierarchy of the 'waterfall mechanism' have resulted in the marginalization of Operational Creditors, particularly with respect to the realization of their debts during the Corporate Insolvency Resolution Process ("CIRP"). In this article, the authors analyze various judicial pronouncements and legislative developments that have led to the subordination of Operational Creditors and also argue for alleviating their position under the Code. This Article is divided into five parts - the first part discusses the statutory provisions to elucidate the position of Operational Creditors under the Code. In the second part, the authors delineate the raison d'être for the differential treatment of the Financial and Operational Creditors in light of the Supreme Court's rulings in the 'Swiss Ribbons' & 'Essar Steel' case. In the next part, the authors outline the repercussions arising out of such differential treatment and provide empirical evidence to demonstrate that Operational Creditors do not receive a fair share during the CIRP under the present scheme of the Code. In the fourth part, the authors propose three changes – representation and pro-rata voting rights for Operational Creditors in CoC, the equitable treatment of similarly placed creditors, and the provision of assured minimum payment - to resolve the predicament of Operational Creditors. The authors finally conclude by highlighting the significant takeaways from this Article.

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I. INTRODUCTION

The Insolvency & Bankruptcy Code, 2016 (**"Code"**)[1] was enacted for the complete overhaul of the insolvency regime in India, which was hitherto plagued by the outdated debt recovery statutes, such as the Sick Industrial Companies Act, 1985 and the Recovery of Debts due to Banks and Financial Institutions Act, 1993. These statutes failed to provide an efficacious time-bound resolution that resulted in exacerbating the value of assets. In its nascent stages, the Code was hailed as a landmark reform as it endeavored to revive the distressed businesses in a time-bound manner by ensuring the maximization of the value of their assets while balancing the interest of other stakeholders.[2] However, as the jurisprudence on various provisions of the Code evolved, the position of Operational Creditors vis-à-vis Financial Creditors substantially weakened, specifically with respect to the realization of their debts during the Corporate Insolvency Resolution Process (**"CIRP"**).

[1] The Insolvency and Bankruptcy Code, 2016, No. 31, Act of Parliament, 2016 (India).
[2] The Insolvency and Bankruptcy Code, 2016, preamble, No. 31, Act of Parliament, 2016 (India).

As the CIRP typically follows a "creditor in control" model for the restructuring of the Corporate Debtor, important decisions pertaining to the insolvency resolution process, including the approval of the resolution plan, are taken by the Committee of Creditors (**"CoC"**).[3] However, the CoC comprises of only Financial Creditors, barring any such creditor who is a 'related party' to the Corporate Debtor.[4] Operational Creditors are granted membership in the CoC only in cases where the Corporate Debtor does not have any Financial Creditors.[5] Furthermore, Operational Creditors can attend meetings of the CoC, provided the amount of their aggregate dues is not less than ten percent of the total debt of the Corporate Debtor.[6] However, Operational Creditors are still not allowed to vote in such meetings.[7] Thus, the rights granted to the Operational Creditors are extremely limited and due to the monopoly of Financial Creditors in the voting process, the resolution plan approved by the CoC in most cases fails to adequately protect the interests of Operational Creditors.

Interestingly, even Section 53(1) of the Code, which prescribes the order of priority amongst creditors for distribution of proceeds during liquidation and under the resolution plan, also referred to as the waterfall mechanism, places debts owed to Operational Creditors at sixth position in

[3] The Insolvency and Bankruptcy Code, 2016, §30(4), No. 31, Act of Parliament, 2016 (India).
[4] The Insolvency and Bankruptcy Code, 2016, §21(2), No. 31, Act of Parliament, 2016 (India).
[5] The Insolvency and Bankruptcy Code, 2016, §21(8), No. 31, Act of Parliament, 2016 (India).
[6] The Insolvency and Bankruptcy Code, 2016, §24(3)(c), No. 31, Act of Parliament, 2016 (India).
[7] The Insolvency and Bankruptcy Code, 2016, §24(4), No. 31, Act of Parliament, 2016 (India).

the category of 'any remaining debts and dues'.[8] This ensures that Operational Creditors, in the event of liquidation of Corporate Debtor or under a resolution plan, receive their dues after secured Financial Creditors, workmen, government taxes, etc., are paid off. It is pertinent to note that while most Financial Creditors, particularly banks and financial institutions, are secured creditors, more often than not Operational Creditors are unsecured—payments for goods and services as well as payments to workers not being secured by mortgaged documents. However, even unsecured Financial Creditors, who similar to Operational Creditors have no collateral security in lieu of the debt owed to them, are placed at fourth position in the order of priority under Section 53(1). Resultantly, Operational Creditors, receive a meager sum compared to unsecured Financial Creditors, who similar to Operational Creditors being unsecured creditors are effectively are at an equal pedestal with them.

The authors, through this paper, will delve into the implications of various judicial pronouncements, which have led to the disenfranchisement of Operational Creditors, and also propose changes, based on developments in different jurisdictions and various committee reports, to argue for the inclusion of Operational Creditors in the CoC and equitable treatment of similarly placed creditors under Code.

[8] The Insolvency and Bankruptcy Code, 2016, §53(1)(f), No. 31, Act of Parliament, 2016 (India).

II. SUBJUGATION OF OPERATIONAL CREDITORS UNDER THE CODE – A JOURNEY FROM SWISS RIBBONS TO ESSAR STEEL

A. THE SWISS RIBBONS JUDGMENT

In the seminal case of *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors*. (**"*Swiss Ribbons*"**),[9] a batch of writ petitions assailing the constitutional validity of various provisions of the Code was filed before the Supreme Court. The Supreme Court in this case had *inter-alia*, examined whether the lack of representation of the Operational Creditors in the CoC and the waterfall mechanism applied in prioritization of claims under Section 53 of the Code was violative of Article 14 of the Constitution.[10]

The Supreme Court, relying on the rationale for exclusion of Operational Creditors from the CoC enumerated in the Bankruptcy Law Reform Committee Report, 2015,[11] concluded that there is an intelligible differentia between Financial and Operational Creditors, which has a direct relation to the objects sought to be achieved by the Code. The Supreme Court took note of the fact that

> Operational Creditors are typically interested only in getting payment for supply of goods or services made by them whereas Financial Creditors are involved in seeing that the entirety of their loan gets repaid, for which they

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[9] Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors., (2019) 4 SCC 17 (hereinafter Swiss Ribbons).

[10] INDIA CONST. art. 14.

[11] BANKRUPTCY LAW REFORMS COMMITTEE, THE REPORT OF THE BANKRUPTCY LAW REFORMS COMMITTEE VOLUME I: RATIONALE AND DESIGN (2015), https://ibbi.gov.in/BLRCReportVol1_04112015.pdf (hereinafterBLRC Report 2015).

> are, from the very beginning, better equipped to go into the viability of Corporate Debtor.[12]

As a result, in times of financial stress, Financial Creditors engage in "restructuring of the loan as well as reorganization of the Corporate Debtor's business", which the Operational Creditors do not and cannot undertake.[13] Thus, the objective of the Code being "the preservation of the Corporate Debtor as going concern, while ensuring maximum recovery for all creditors, Financial Creditors are clearly different from Operational Creditors," and therefore, exclusion of Operational Creditors from CoC does not infract Article 14 of the Constitution.[14]

As regards the constitutional validity of Section 53, which places Operational Creditors below all other creditors, including unsecured Financial Creditors during the distribution of assets, the Supreme Court observed that "repayment of financial debts infuses capital into the economy inasmuch as banks and financial institutions are able, with the money that has been paid back, to further lend such money to other entrepreneurs for their businesses."[15] This rationale, according to the Supreme Court, creates an intelligible differentia between financial debts and operational debts, having a direct relation to the object sought to be achieved by the Code.

B. THE NCLAT'S VERDICT IN ESSAR STEEL

Several key aspects related to the treatment of Operational Creditors under the Code have also been clarified by the Supreme Court in the case of *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta*

[12] Swiss Ribbons, *supra* note 9, at ¶4.
[13] Swiss Ribbons, *supra* note 9, at ¶28.
[14] *Id.*

& Ors. (**"*Essar Steel*"**).[16] This case involved the insolvency resolution of Essar Steel India Limited, wherein the CoC had initially approved the resolution plan submitted by Arcelor Mittal India Private Limited, which stipulated 0% payment to Operational Creditors. In contrast, the Financial Creditors were proposed to be paid 92.5% of their dues.

In its order[17] dated July 4, 2019, the National Company Law Appellate Tribunal (**"NCLAT"**) found the proposed distribution of assets under the resolution plan to be discriminatory. The NCLAT held that in the matter of payment of dues, a resolution plan must not discriminate between a Financial Creditor and an Operational Creditor. The NCLAT reasoned that

> the 'Financial Creditors' being Claimants at par with other Claimants like other 'Financial Creditors' and the 'Operational Creditors' having a conflict of interest cannot distribute the amount amongst themselves that too keeping the maximum amount in favour of one or other 'Financial Creditors' and minimum or 'NIL' amount in favour of some other 'Financial Creditors' or the 'Operational Creditors'.[18]

Accordingly, it directed modification in the resolution plan to ensure approximately 60.7% recovery of admitted claims to all the creditors.

Further, according to the NCLAT, there is a distinction between the distribution of assets during a "resolution" process as against under a "liquidation" process and resultantly, Section 53, which lays out the order of

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[15] Swiss Ribbons, *supra* note 9, at ¶84.
[16] Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta & Ors., (2020) 8 SCC 531.
[17] Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta & Ors., Company Appeal (AT) (Ins.) No. 265 of 2019.
[18] *Id.* at ¶140.

priority for the proceeds from the sale of the "liquidation" assets, could not be applied to determine the distribution of funds to the creditors under the resolution plan.[19]

C. INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT) ACT, 2019

Indian banks vehemently criticized the NCLAT's decision as it not only significantly decreased their recovery from approximately 92.5% to 60.7% of admitted claims in the CIRP of Essar Steel India Limited but also muddled with the distinction between secured and unsecured creditors.

Pursuant to the NCLAT's verdict, the parliament, to safeguard the interests of Indian Banks, introduced the Insolvency and Bankruptcy Code (Amendment) Act, 2019 (hereinafter "IBC Amendment Act")[20] dated August 6, 2019, with retrospective effect. The IBC Amendment Act, *inter-alia*, amended Section 30(2)(b) to mandate that Operational Creditors should be paid higher of "the amount to be paid to such creditors in the event of liquidation of Corporate Debtor under Section 53" and "the amount that would have been paid to such creditors if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority under sub-section (1) of section 53."[21] An explanation was also added to Section 30(2)(b), which expressly clarified that "distribution in accordance with the provisions of this clause shall be considered fair and

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[19] *Id*. at ¶170.
[20] The Insolvency and Bankruptcy Code (Amendment) Act, 2019, No. 26, Act of Parliament, 2019 (India).
[21] *Id.* at §6 (a).

equitable."[22] A writ petition challenging the constitutionality of the IBC Amendment Act along with the appeals against the order of NCLAT in *Essar Steel* was filed before the Supreme Court.

D. THE SUPREME COURT'S VERDICT IN ESSAR STEEL

By its judgment dated November 15, 2019, the Supreme Court upheld the constitutional validity of the IBC Amendment Act and also set aside the order of NCLAT.[23] Clarifying the scope of amended Section 30(2) of the Code, the Supreme Court observed that the "equality principle cannot be stretched to treating unequals equally, as that will destroy the very objective of the Code - to resolve stressed assets."[24] Consequently, considering the business relations of Financial and Operational Creditors with the Corporate Debtor, both could not be placed on an equal footing and it was permissible to treat different classes of creditors differently as long as the differential treatment is equitable and based on reasonable grounds. The Supreme Court further noted that the Code itself provides certain mechanisms like "priority in repayment of dues" and "mandatory disclosure in a resolution plan regarding the treatment of Operational Creditors' interests" to ensure fair and equitable treatment of Operational Creditors.[25] Accordingly, the Supreme Court ruled that the discretion of distribution of funds is with the CoC, provided such a decision upholds the objectives of the Code.[26]

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[22] *Id.*
[23] Essar Steel, *supra* note 16.
[24] Essar Steel, *supra* note 16, at ¶57.
[25] The Insolvency and Bankruptcy Board of India (Insolvency Resolution of Process of Corporate Persons) Regulations, 2016, regulation 38 (1A).
[26] Essar Steel, *supra* note 16.

The analysis of the journey from *Swiss Ribbons* to *Essar Steel* is evident to conclude that the judiciary has decided in favor of the Financial Creditor, leaving the Operational Creditors to the fate of the commercial wisdom of CoC.

III. THE IMPLICATIONS OF DIFFERENTIAL TREATMENT: RATIONALE FOR PROTECTION OF OPERATIONAL CREDITORS

Although there are numerous reasons behind the precedence granted to Financial Creditors as elucidated by the Supreme Court in *Swiss Ribbons* and *Essar Steel*, the concomitant disadvantages of the differential treatment are manifold. The NCLAT in *Binani Industries Limited v. Bank of Baroda,*[27] while discussing the hierarchy of claims and the priority in the distribution of assets, observed that "if one type of credit is given preferential treatment, the other type of credit will disappear from the market. This will be against the objective of promoting the availability of credit."[28] Thus, due to deprioritized debt claims, Operational Creditors may be hesitant in providing large amounts of credits or even demand advance payments for goods and services.

Further, as Operational Creditors are not allowed representation in the CoC, they are unable to vote on any decision pertaining to the CIRP, including the approval or rejection of the resolution plan. The rationale for the same has been already discussed in *Swiss Ribbon* as highlighted in Part II of the Article. However, such a rationale for the exclusion of Operational

[27] Binani Industries Ltd. v. Bank of Baroda & Anr., Company Appeal (AT) (Insolvency) No. 82 of 2018.
[28] *Id.* at ¶17.

Creditors from voting on a resolution plan does not apply in certain situations. For instance, many Financial Creditors like homebuyers lack the 'ability to assess the viability of Corporate Debtor' as well as 'incentive to take haircuts, still, they are allowed to vote in a resolution plan as members of a class. Moreover, where a Corporate Debtor does not have any Financial Creditors, Operational Creditors, on rare occasions, constitute the CoC. This implies that the current framework accepts that Operational Creditors have the requisite capability to vote on a resolution plan in some situations and therefore, the rationale for excluding Operational Creditors is flawed.

Ultimately, due to such disenfranchisement, Operational Creditors are left at the wisdom and generosity of CoC and the Resolution Applicant. The only protection offered to Operational Creditors is Section 30(2)(b) of the Code, which due to large outstanding debts of Corporate Debtor and hierarchy of waterfall mechanism, becomes redundant as seen in several cases discussed in the last part of this section.

It is also pertinent to note that the Supreme Court in *Essar Steel* had adverted to Report of the Insolvency Law Committee, 2018,[29] to rule that different classes of creditors can be treated differently. The said report stated that

> most of the resolution plans are in the process of submission and there is no empirical evidence to further the argument that operational creditors do not receive a fair share in the resolution process under the current scheme of the Code. Hence, the Committee decided to

[29] MINISTRY OF CORPORATE AFFAIRS, REPORT OF THE INSOLVENCY LAW COMMITTEE (2018), https://mca.gov.in/Ministry/pdf/ReportInsolvencyLawCommittee_12042019.pdf .

> continue with the present arrangement without making any amendments to the Code.[30]

However, post the publication of the Report of the Insolvency Law Committee, 2018, there were numerous cases, which the Supreme Court in *Essar Steel* failed to take into account, where due to the distribution of assets as per the waterfall mechanism and established judicial precedents on the 'sanctity of the commercial wisdom of CoC'[31], the courts and tribunals have approved resolution plans offering NIL or insignificant amounts to Operational Creditors.

For instance, in the insolvency resolution of Alok Industries Limited,[32] the resolution plan of Reliance Industries Ltd-JM Financial Asset Reconstruction Ltd. approved by the National Company Law Tribunal (**"NCLT"**), Ahmedabad paid Financial Creditors Rs. 5,052 crores out of Rs. 29,614 crores i.e., 17% of their debt claims. At the same time, Operational Creditors received no amount against their debt claim of Rs. 592 crores since liquidation value estimated for Corporate Debtor was insufficient to pay the debt of Financial Creditors in full.[33] Likewise, in the matter of *Standard Chartered Bank DBS Bank Limited v. Ruchi Soya Industries Limited*,[34] the NCLT Mumbai approved a resolution plan by Patanjali Ayurved Limited, under which the Financial Creditors received Rs. 4,093 crores, satisfying 43.2% of their admitted claims out of Rs. 9,454 crores, while only Rs 90

[30] *Id.* at ¶18.5.
[31] K Sashidhar v.Indian Overseas Bank & Ors.,(2019)12SCC150; Essar Steel, *supra* note 16.
[32] *State Bank of India v. Alok Industries Ltd., CP(IB) No. 48 of 2017.*
[33] *State Bank of India v. Alok Industries Ltd.,IA 259 of 2018 in CP(IB) No. 48 of 2017, at ¶21.*
[34] Standard Chartered Bank DBS Bank Ltd. v. Ruchi Soya Industries Ltd., MA 1721/2019, MA 1428/2019, MA 1746/2019 & MA 1816/2019 in CP (IB) 1371 & 1372 (MB)/2017.

crores were paid to Operational Creditors, satisfying merely 3% of their admitted claims out of Rs. 2,716 crores.

Similarly, in the case of *Pacific World Shipping PTE Ltd. v. Dadi Implex Pvt. Ltd,*[35] the NCLAT approved the resolution plan under which the Operational Creditors were given only 2% of their claims compared to Financial Creditors, who were awarded 100% of their claims. Even in *Essar Steel,* the final resolution plan by Arcelor Mittal India Private Limited resulted in 89% recovery to almost all the secured Financial Creditors, whereas the Operational Creditors could only recover 20% of their admitted claims.[36]

The above cases illustrate that Operational Creditors do not receive a fair share in the resolution process, and hence, due to these rulings, the contrary assertion made in the Report of the Insolvency Law Committee, 2018, also referred to in *Essar Steel,* has been now rendered incorrect.

IV. PROPOSED SUGGESTIONS

After analyzing the problems inherent in the current regime, which have led to the predicament of Operational Creditors under the Code, the authors hereby propose three solutions that can effectively resolve the issues at hand. The proposed solutions are as follows: -

[35] Pacific World Shipping PTE Ltd. v. Dadi Implex Pvt. Ltd., Company Appeal (AT) (Ins) No. 728 of 2019.
[36] Essar Steel, *supra* note 16.

A. REPRESENTATION IN COC & VOTING RIGHTS

Although the Supreme Court in *Swiss Ribbon* has legitimized the exclusion of Operational Creditors from the CoC, it is pertinent to discuss the position of Operational Creditors in different jurisdictions and analyze whether the Indian regime is in consonance with the international jurisprudence. It is noteworthy that the Code was drafted after taking into consideration the insolvency and bankruptcy laws of the USA, UK, and Singapore. For instance, the UK's principle of "creditor-in-control" model has been incorporated by India in the Code, the concept of 180 days moratorium has been borrowed from Chapter 11 of the US Bankruptcy Code, 1978, etc.[37] However, unlike India where creditors are classified into Financial and Operational Creditors, the Insolvency Laws in these jurisdictions categorize creditors into secured creditors, which are mostly Financial Creditors and unsecured creditors that include Operational Creditors.

1. *United States of America ("U.S.A.")*

In the U.S., bankruptcy cases are governed by Chapter 11 of the Bankruptcy Code, 1978 and pursuant to the filing of this Chapter 11 petition, the trustee appoints a committee of unsecured creditors, comprising of twenty largest unsecured creditors of the debtor.[38] This committee plays a pivotal role in the insolvency resolution process by consulting with the debtor about the administration of the case, investigating the debtor's

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[37] Ernst & Young, How Does the Corporate Insolvency Code in India Measure with the UK? - Insolvency/Bankruptcy/Re-Structuring – India, MONDAQ (December 8, 2016), https://www.mondaq.com/india/insolvencybankruptcy/551286/how-does-the-corporate-insolvency-code-in-india-measure-with-the-uk.

conduct, formulating the restructuring plan, etc.[39] Further, Chapter 11 requires creditors to be designated into classes and the confirmation of the reorganization plan requires acceptance of a plan by the impaired classes of claims and interests, i.e*.,* "by creditors holding at least two-thirds in amount and more than one-half in the number of the allowed claims and holders of at least two-thirds in amount of the allowed interests."[40] Thus, unlike the Code, the impaired class of creditors, which includes Operational Creditors that are bundled into the unsecured creditors category also has the right to vote on any restructuring proposal.

2. United Kingdom ("U.K.")

The bankruptcy law in the U.K. also maintains the traditional distinction between secured and unsecured creditors. The scheme of arrangement proposed under the U.K. Companies Act, 2006, when the company is in administration (or insolvency resolution) mandates the approval of at least 50% in number, representing 75% in value of each class of creditors.[41] Further, all creditors including Operational Creditors have voting powers in the creditors' committee in the ratio of the amount outstanding particularly for the approval of a resolution plan.

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[38] Bankruptcy Code, 1978, §1102, 11 U.S.C.
[39] Peter C. Blain and Diane Harrison O'Gawa, *Creditors' Committees under Chapter 11 of the United States Bankruptcy Code: Creation, Composition, Powers and Duties*, 67 MARQ. L. REV 491 (1984).
[40] Bankruptcy Code, 1978, §§1126(c), 1129(8), 11 U.S.C.
[41] Companies Act, 2006, §899 (U.K.).

3. *European Union ("E.U."):*

The Insolvency & Bankruptcy Laws in the E.U. nations are governed by the E.U. Regulation on Insolvency Proceedings, 2000.[42] Regulation 2, Article 9 of the Directive on Restructuring & Insolvency[43] directs the member states to ensure that affected parties have a right to vote on the adoption of a restructuring plan. As per Regulation 3, only three classes of creditors are denied voting rights at the time of adoption of the plan, namely the Equity Shareholders, a related party of the debtors and creditors whose claims are ranked below unsecured creditors such as shareholders other than Equity Shareholders, tax or social security authorities, small suppliers, etc.[44] Hence, E.U. nations provide voting rights to unsecured creditors at the time of adoption of the restructuring plan.

4. *Singapore:*

The Corporate Restructuring and Insolvency Laws in Singapore are governed by the Singapore Companies Act along with the Insolvency, Restructuring and Dissolution Act, 2018.[45] The proposed Scheme of Arrangement must be approved by a majority of the creditors present and voting in each class and this majority must represent at least three-fourth of the voting class members.[46] Generally, the voting class includes secured creditors, creditors with preferential claims, unsecured creditors, etc.

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[42] European Parliament and the Council Directive (EU) 2019/1023, 2019 O.J. (L.172) 18.
[43] European Parliament and the Council Directive (EU) 2019/1023, art. 9, clause 2, 2019 O.J. (L. 172) 44.
[44] European Parliament and the Council Directive (EU) 2019/1023, art. 9, clause 3, 2019 O.J. (L. 172) 44.
[45] Insolvency, Restructuring and Dissolution Act,2018 (Singapore).
[46] *Id.*at §357.

After a detailed perusal of the Insolvency and Bankruptcy laws of different jurisdictions, it is evident that the complete exclusion of Operational Creditors from CoC and conspicuous disempowerment of Operational Creditors in the decision-making process is not only contrary with the laws of other jurisdictions but also appears to be based on flawed reasoning. Providing voting rights to Operational Creditors on any proposal regarding the approval of the resolution plan adds an important element of procedural fairness and further bolsters the objective of the Code, which is to protect the interests of all the stakeholders. Representation in CoC and voting rights will bestow Operational Creditors a right to block the resolution plan if their interests are not adequately represented. Considering that a resolution plan cannot discriminate among similarly placed creditors, the approval by even a small percentage of Operational Creditors would benefit their entire class. Hence, the current position wherein the Operational Creditors are deprived of voting rights is patently unfair and lacks sufficient reasoning.

In view of the foregoing, the authors are of the considered opinion that the current position of law should be reconsidered and the appropriate legislative amendment should be introduced to include Operational Creditors in the CoC and provide them with pro-rata voting rights. In the alternative, a separate committee of Operational Creditors can also be constituted and any resolution plan will then also have to be approved by such a committee.

The Legislative Guide on Insolvency Laws issued by United Nation Commission on International Trade Law (**"LGIL by UNCITRAL"**) further supports the views of the author as it specifically states that "insolvency legislations should facilitate the active participation of the creditors in insolvency proceedings, such as through a creditors' committee, a special representative, or other mechanisms for representation."[47] The LGIL by UNCITRAL also highlights that to ensure equality of treatment of creditors, it is desirable to constitute separate committees, where the interests of unsecured creditors are not adequately represented through the constitution of a single committee.[48]

Moreover, the Report of the Insolvency Law Committee, 2020,[49] has emphasized extensively on conferring voting rights to Operational Creditors. The Committee has noted that "the degree of creditor participation is considered a key factor in determining the effectiveness of an insolvency regime."[50] Hence, if the Code will not grant Operational Creditors with a right to express their dissent against a resolution plan, "it may lead to a lack of trust and confidence among operational creditors at the time of the final outcome of the Resolution Process."[51] Accordingly, it is concluded that to ensure that the CIRP is regarded as a fair and just process, Operational Creditors should be conferred with voting rights in the future.

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[47] United Nations Commission on International Trade Law, *Legislative Guide on Insolvency Law,* (2005) 203 https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf (hereinafter LGIL UNCITRAL).
[48] *Id.* at 198.
[49] MINISTRY OF CORPORATE AFFAIRS, REPORT OF THE INSOLVENCY LAW COMMITTEE (2020) http://www.mca.gov.in/Ministry/pdf/ICLReport_05032020.pdf (hereinafter ILC Report 2020).
[50] *Id.* at ¶10.2.
[51] ILC Report 2020, *supra* note 49, at ¶10.3.

B. ENSURE EQUITABLE TREATMENT TO SIMILARLY PLACED CREDITORS

The position of Operational Creditors under the Code has also been exacerbated due to sheer discrimination even between unsecured Financial and Operational Creditors. Section 53 of the Code (priority of repayment in the event of liquidation) places unsecured Financial Creditors at the fourth position whereas, Operational Creditors, who are mostly unsecured, are placed at the sixth position.[52] Thus, the Code, apart from discriminating between secured and unsecured creditors, further discriminates between two similarly placed creditors – unsecured Financial and Operational Creditors. Although the Bankruptcy Law Reforms Committee Report, 2015 justifies the differential treatment accorded to different classes of creditors, which was also reiterated by the Supreme Court in *Swiss Ribbons,* it remains silent for not treating unsecured creditors at par.[53] Moreover, in *Essar Steel*, the Supreme Court had emphasized on the principle of equality among "similarly placed creditors"[54] Thus, in the opinion of the authors, differential treatment of unsecured Financial and Operational Creditors under Section 53 contravenes the established jurisprudence on this aspect.

The views of the authors are also supported by Objective 4 of the LGIL by UNCITRAL, which envisages that creditors, irrespective of origin, should receive treatment proportionate with their status vis-à-vis other similarly situated creditors.[55] Therefore, there is a need for amendment in the

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[52] The Insolvency and Bankruptcy Code, 2016, §53(1), No. 31, Act of Parliament, 2016 (India).
[53] BLRC Report 2015, *supra* note 11.
[54] Essar Steel, *supra* note 16.
[55] LGIL UNCITRAL, *supra* note 47, objective 4.

order of priority prescribed under Section 53(1) to ensure equitable treatment of the similarly placed creditors under the Code.

C. ASSURED MINIMUM PAYMENT

The Indian courts and tribunals, in a few remarkable judicial pronouncements, have recognized the existing lacunas in the Code and have accordingly tried to safeguard the interests of Operational Creditors. The Supreme Court in *Rajputana Properties Pvt. Ltd. v. Ultratech Cement Ltd.*[56] had held that "the dues of Operational Creditors must get at least similar treatment compared to the dues of Financial Creditors."[57] Similarly, the NCLAT in the *Essar Steel* had modified the resolution plan to ensure "equitable recovery to all the creditors" while holding that "the waterfall mechanism in Section 53 is not relevant in determining the distribution of funds under a resolution plan."[58] However, by introducing the IBC Amendment Act of 2019, the parliament neutralized the implications of these rulings, thereby shrouding any ray of hope for Operational Creditors.

Although Operational Creditors under every resolution plan are entitled to a minimum payment of liquidation value of the Corporate Debtor, due to the hierarchy of the waterfall mechanism, the statutory minimum is extremely inadequate and, in many cases, results in NIL or insignificant recovery to Operational Creditors. The empirical evidence in this regard has already been provided in *Part III* of the Article and can also be understood through the following illustration.

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[56] Rajputana Properties Pvt. Ltd. v. Ultratech Cement Ltd., (2021) 3 CompLJ 126 (SC).
[57] *Id.*
[58] Essar Steel NCLAT, *supra* note17.

Consider a case where the Liquidation Cost is Rs. 1 crore and the admitted claims of different creditors are as follows:(a) secured Financial Creditors - Rs 5 crore; (b) unsecured Financial Creditors - Rs 3 crore; and (c) Operational Creditors - Rs 2 crore. Now, suppose an amount of Rs 7 crore is to be distributed in a resolution plan. In that case, the Liquidation Cost, being at the top of priority under Section 53, would be paid in full, followed by complete repayment of Rs 5 crore to secured Financial Creditors and a payment of just Rs 1 crore to unsecured Financial Creditors. However, since the Operational Creditors are at the bottom of priority, they would receive no amount at all.

In such scenarios, the authors believe that the concept of "Assured Minimum Payment" can help the Indian Insolvency Regime protect the rights of the Operational Creditors. A provision for Assured Minimum Payment in the Code will ensure that a minimum amount (which can be specified in the amendment) is paid to the Operational Creditor in cases where they are awarded NIL or an insignificant amount under the resolution plan.[59] This will ensure more equitable treatment of the Operational Creditors and protect their interests to a large extent. Further, it is pertinent to mention the NCLAT's decision in *Hammond Power Solutions Private Limited v. Sanjit Kumar and Ors.,*[60] wherein the NCLAT, following *Essar Steel*, made it mandatory for Resolution Applicant to explain as to how the

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[59] Vinson Kurian, Redraft IBC to give proportionate vote to Operational Creditors, THE HINDU BUSINESSLINE (Mar. 2, 2021), https://www.thehindubusinessline.com/economy/redraft-ibc-to-give-proportional-vote-to-operational-creditors/article33972311.ece?utm_campaign=amp_article_share&utm_medium=referral&utm_source=whatsapp.com.

[60] Hammond Power Solutions Private Ltd. v. Sanjit Kumar and Ors., Company Appeal (AT) (Ins) No. 606 of 2019.

interests of all stakeholders are taken care of. The strict implementation of the aforesaid direction in all cases will ensure that Resolution Applicant cannot justify huge haircuts to Operational Creditors under the resolution plan.

V. CONCLUSION

Operational Creditors are important stakeholders in any business, with the supply of goods and services being indispensable for a business to function. As an economy does not run merely on the financial system, businesses rely on Operational Creditors for their operations and working capital requirements. In such a scenario, the protection of the rights of Operational Creditors is of paramount importance.

Despite the objective of balancing interests of all stakeholders enshrined in the preamble of the Code and emphasis in various committee reports[61] that Operational Creditors need protection when the resolution plan is devised, no steps to date have been taken to this effect. The Operational Creditors are neither allowed to be a part of CoC nor provided with voting rights to approve or reject a resolution plan (except when there are no Financial Creditors of Corporate Debtor). Further, debts owed to Operational Creditors, who are mostly unsecured, fall in any remaining debts and dues category under Section 53, trailing behind all and sundry, including their counterpart – unsecured Financial Creditors. Consequently, Section 30(2)(b)(i), which guarantees a minimum liquidation amount under every resolution plan to Operational Creditors, is rendered infructuous, resulting in abysmally low debt realizations to Operational Creditors, both in liquidation

[61] BLRC Report 2015, *supra* note 11; ILC Report 2018, *supra* note 29.

and resolution. Thus, Operational Creditors are not afforded any commensurate protections in exchange for their deprioritized debt claims.

With the aforesaid shortcomings under the present regime, the authors, through this paper, have put forth three proposals that can effectively resolve the predicament of Operational Creditors under the Code. *First*, Operational Creditors should be provided a proportionate representation in the CoC and pro-rata voting rights. Another option that can be explored is the constitution of a separate committee for Operational Creditors, which will require approval of the resolution plan by a specified percentage of its members. Report of the Insolvency Law Committee, 2020 has also recommended that Operational Creditors, subject to fulfillment of specific criteria, should be conferred with voting rights. The inclusion of Operational Creditors in the CoC will improve the overall effectiveness of the Code by making the entire resolution process more transparent, representational, and inclusive.

Second, Section 53 of the Code should be amended to ensure equitable treatment to similarly placed creditors, viz. unsecured Financial and Operational creditors, at the time of distribution of assets during resolution and liquidation. The LGIL by UNCITRAL also exhorts that creditors should receive a treatment that is proportionate with their status vis-à-vis other similarly situated creditors. *Third*, in light of a catena of cases wherein Operational Creditors have been offered NIL or insignificant amounts under the resolution plan, a provision of Assured Minimum Payment for Operational Creditors should be introduced. This measure becomes even more necessary as the statutory minimum under Section 30(2)(b) has proven inadequate and even redundant in many cases.

The authors believe that the Indian lawmakers should reflect upon these proposals since there is a compelling need to facilitate changes under the Code. The above proposals, apart from addressing the concerns and ensuring more equitable treatment of Operational Creditors, would assist in truly fulfilling the much-revered objectives of the Code.