

## OPERATIONAL CREDITORS IN INSOLVENCY: A TALE OF DISENFRANCHISEMENT

*Sudip Mahapatra, Pooja Singhania & Misha Chandna\**

*The objective of this Article is to explain the unique predicament of operational creditors under the Insolvency and Bankruptcy Code, 2016 (IBC). It examines the various factors considered by the judiciary in recent pronouncements that have contributed to such a predicament and outline solutions that could be considered for a constructive resolution of the issues at hand. This Article is divided into four parts – the first part discusses certain issues considered by the Supreme Court in Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others, and its key findings in this regard.*

*In the second part, the authors argue that the IBC and the ruling of the Supreme Court unfairly disadvantage operational creditors, and as a solution, suggest that such creditors be given representation in the Committee of Creditors in line with international practice.*

*In the third part, the authors point out a lacuna in the IBC regarding the treatment of the claims of creditors with ‘disputed’ claims in an insolvency resolution process and propose an alternate framework to determine such claims. The last part underscores the key takeaways from this Article and our concluding thoughts.*

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\* Sudip Mahapatra is a Partner at S&R Associates, Pooja Singhania is a Senior Associate at S&R Associates and Misha Chandna is an Associate at S&R Associates. The authors are based out of its Mumbai office.

## CONTENTS

INTRODUCTION.....	79
I. THE JUDGMENT IN ESSAR STEEL.....	80
II. THE DISENFRANCHISEMENT OF OPERATIONAL CREDITORS .....	83
III. TREATMENT OF DISPUTED CLAIMS: AN UNRESOLVED PARADOX.....	88
CONCLUSION .....	91

## INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (hereinafter “IBC”)<sup>1</sup> was hailed as a major reform in the insolvency landscape in India. The IBC was enacted in the context of a mounting ‘non-performing assets’ crisis and the failure of debt recovery statutes such as the Sick Industrial Companies Act, 1985 and the Recovery of Debts due to Banks and Financial Institutions Act, 1993, which were plagued by inordinate delays that led to the resultant loss of the value of the assets. Accordingly, a key objective behind the enactment of the IBC was the insolvency resolution of corporate persons “*in a time bound manner for maximization of value of assets of such persons*”.<sup>2</sup> Additionally, the IBC sought to bring about a paradigm shift from the debtor-in-control model to a creditor-driven process. The restriction on defaulting promoters from acquiring companies under the IBC pursuant to the introduction of Section 29A of the IBC was yet another key step towards this shift.

The IBC has made some progress in meeting its objectives. While numerous issues (both substantive and procedural) remain open, the Supreme Court of India has clarified a few key issues in its judgment dated November 15, 2019, in *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others* (hereinafter “*Essar Steel*”).<sup>3</sup> Specifically, the Supreme Court has held that equal treatment need not be meted out to the operational creditors and financial creditors under a resolution plan. Further, the Court ruled that all the pre-insolvency liabilities of the corporate debtor

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<sup>1</sup> The Insolvency and Bankruptcy Code, 2016, No. 37, Acts of Parliament, 2016.

<sup>2</sup> Insolvency and Bankruptcy Code, 2016, Preamble.

<sup>3</sup> *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others*, (2020) 1 CompLJ 1 (Supreme Court).

would stand extinguished upon its successful resolution. The ruling of the Supreme Court seemingly brings much vital on issues critical for secured financial creditors and resolution applicants. At the same time, it is likely to result in certain inequitable consequences for operational creditors including creditors with disputed claims. For context, financial creditors have a purely financial arrangement with the corporate debtor while operational creditors include those creditors who are owed money by the corporate debtor for the provision of goods and services.

## I. THE JUDGMENT IN ESSAR STEEL

A key concern in respect of the IBC since its inception has been the treatment of the different classes of creditors of the corporate debtor. As an insolvency resolution under the IBC is a creditor-driven process, most decisions in respect of the corporate debtor during its insolvency resolution period including the approval of a resolution plan, are taken by a ‘committee of creditors’ (hereinafter “CoC”). The CoC comprises all the financial creditors of the corporate debtor (except financial creditors related to the corporate debtor). Operational creditors are granted representation in the CoC only in the event that the corporate debtor does not have any financial creditors. The right to attend the meetings of the CoC is also limited to operational creditors having an aggregate debt of at least 10% of the total debt of the corporate debtor. Given that operational creditors are typically not granted representation in the CoC and do not have a say in the decision-making process, the protection of the interests of such creditors has been rather controversial.

Prior to August 16, 2019, Section 30(2)(b) of the IBC mandated that a resolution plan “provides for the payment of the debts of operational creditors in such manner as may be specified by the Board 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 under section 53”.<sup>4</sup> In effect, the minimum payment to operational creditors under a resolution plan could not be less than the liquidation value of such operational debt. However, as a practical matter, given the large outstanding debt of most corporate debtors, the liquidation value of such operational debt would, in almost all instances, be zero<sup>5</sup> – thereby, not affording any meaningful protection to the operational creditors despite appearing to.

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<sup>4</sup> Insolvency and Bankruptcy Code, 2016, §30(2)(b).

<sup>5</sup> Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others, (2020) (Supreme Court), *supra* note 3 at ¶46.

In the context of the preceding paragraphs, the decision in *Essar Steel* clarifies certain key aspects associated with the treatment of operational creditors under the IBC. To appreciate the full purport and effect of the judgment, it is necessary to examine certain findings recorded by the National Company Law Appellate Tribunal (hereinafter “NCLAT”) in its order dated July 4, 2019. The order of the NCLAT approved the resolution plan submitted by ArcelorMittal India Private Limited (hereinafter “ArcelorMittal”) for Essar Steel India Limited (hereinafter “Essar Steel”).<sup>6</sup>

ArcelorMittal's resolution plan (as amended by the CoC) contemplated the payment of the entire dues of the operational creditors with an admitted claim of less than INR 1 crore and an additional INR 1,000 crore payment towards the dues of operational creditors with an admitted claim exceeding INR 1 crore, over and above the payment of INR 42,000 crore to the secured financial creditors. Under such a resolution plan, the manner of distribution of funds among the secured financial creditors was left to the discretion of the CoC. The CoC decided on a *pro rata* recovery for all secured financial creditors (except Standard Chartered Bank), according to which almost all such secured financial creditors would have recovered approximately 90% of their dues.

The NCLAT found the proposed distribution of funds under the resolution plan of ArcelorMittal to be discriminatory. In its finding, the NCLAT relied on the judgment of the Supreme Court in *Swiss Ribbons v. Union of India* (hereinafter “*Swiss Ribbons*”).<sup>7</sup> According to the NCLAT, Section 53 of the IBC (priority of repayment in the event of liquidation)<sup>8</sup> was not relevant to determine the distribution of funds to the creditors under a corporate insolvency resolution process. The NCLAT modified the resolution plan of ArcelorMittal to ensure approximately 60.7% recovery to *all* creditors (secured financial creditors, unsecured financial creditors, and operational creditors). Appeals challenging the NCLAT's decision were filed, among others, by the CoC and ArcelorMittal.

The order of the NCLAT resulted in a huge outcry among Indian banks, as it not only significantly reduced their recovery in the Essar Steel process but also sought to do away the distinction between secured and unsecured creditors entirely. To safeguard the interests of the Indian banks, the Parliament introduced the Insolvency and Bankruptcy Code (Amendment) Act,

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<sup>6</sup> Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others (NCLAT order dated July 4, 2019 in Company Appeal (AT) (Ins.) No. 265 of 2019).

<sup>7</sup> *Swiss Ribbons and others v. Union of India and others*, (2019) 4 SCC 17.

<sup>8</sup> Insolvency and Bankruptcy Code, 2016, §53.

2019 (hereinafter the “IBC Amendment Act”) with effect from August 16, 2019.<sup>9</sup>

The IBC Amendment Act, *inter alia*, amended Section 30(2)(b) of the IBC with retrospective effect. The amended provision requires that the operational creditors be paid the higher of the liquidation value of their debt under Section 53 of the IBC and the amount such creditors would be entitled to receive, if the amount proposed to be paid under a resolution plan was distributed in accordance with Section 53 of the IBC.<sup>10</sup> An explanation added to the amended provision expressly provides that a distribution in accordance with such sub-section would be considered “*fair and equitable*”.<sup>11</sup> Writ petitions challenging the constitutionality were filed by various creditors before the Supreme Court.

Pursuant to its judgment in *Essar Steel*, the Supreme Court approved ArcelorMittal’s resolution plan. The Supreme Court held that the principle of ‘equality’ could not be interpreted to mean that all creditors would be entitled to equal recovery under a resolution plan. The Supreme Court underscored that the IBC itself contemplated operational creditors as a separate class of creditors. Further, certain protections, such as the priority in repayment of dues and mandatory disclosure in a resolution plan regarding the treatment of operational creditors’ interests, were built into the IBC to ensure fair and equitable dealing of the dues of the operational creditors. Accordingly, the Supreme Court in *Essar Steel* held that the CoC could approve resolution plans, which provided for differential payments to the financial and operational creditors.<sup>12</sup>

While the Supreme Court in *Essar Steel* set aside the principle of equal treatment of all creditors as adopted by the NCLAT, it recognised the contribution of the operational creditors<sup>13</sup> in keeping the corporate debtor running as a going concern. Thus, the Court recognised the need to protect their interests. The decision in *Essar Steel* maintains that the ultimate discretion of deciding the distribution of funds is with the CoC. However, such a decision should show adequate

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<sup>9</sup> Rajya Sabha debate on the Insolvency and Bankruptcy Code (Amendment) Bill, 2019, July 29, 2019, 205-208.

<sup>10</sup> The Insolvency and Bankruptcy Code (Amendment) Act, 2019, §6(a).

<sup>11</sup> *Id.*

<sup>12</sup> Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others, (2020) (Supreme Court), *supra* note 3.

<sup>13</sup> This category often includes vendors and suppliers of critical goods and services availed by the corporate debtor and its employees.

consideration of the objectives of the IBC which are: (i) the maximisation of the value of assets of the corporate debtor; and (ii) balancing the interests of all stakeholders.<sup>14</sup>

It is noteworthy that the resolution plan of ArcelorMittal as finally approved by the Supreme Court, resulted in a 20% recovery for the operational creditors with admitted claims, in comparison to the approximately 89% recovery for almost all the secured financial creditors. This was a marked departure from the ruling of the Supreme Court in *Swiss Ribbons*, which had relied on the dues of the operational creditors and financial creditors being given “*roughly the same*” treatment.<sup>15</sup> Whether such a significant difference in recovery could be considered ‘equitable’ for operational creditors appears to be questionable.

## II. THE DISENFRANCHISEMENT OF OPERATIONAL CREDITORS

In *Essar Steel*, the Supreme Court rightly upheld the principle of equality among “*similarly placed creditors*” (and not ‘all’ creditors) and the constitutionality of the amended Section 30(2)(b) of the IBC. This expressly included the minimum payment of liquidation value to operational creditors.<sup>16</sup> However, the Supreme Court has failed to adequately consider the interests of the operational creditors and lay down attendant guidelines to ensure their equitable treatment in an insolvency resolution process under the IBC.

The Supreme Court has held that the decision of the CoC must reflect that it has “*taken into account*” the objectives of the IBC of the maximisation of the value of the assets of the corporate debtor and balancing the interests of all stakeholders<sup>17</sup> (including operational creditors). However, placing such an obligation on the CoC is vague at best. The Supreme Court further held that the “*limited*” jurisdiction of the Adjudicating Authority, i.e. the National Company Law Tribunal (hereinafter “NCLT”), includes a review of whether the CoC has taken into account such objectives and interests although such a power of review cannot be exercised to interfere with the “*commercial wisdom*” of the CoC.<sup>18</sup> Given the unrestricted scope of review of the NCLT and the potentially wide

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<sup>14</sup> Insolvency and Bankruptcy Code, 2016, Preamble.

<sup>15</sup> *Swiss Ribbons*, *supra* note 7.

<sup>16</sup> *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others*, (2020) (Supreme Court), *supra* note 3.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

scope of the ‘commercial wisdom’ of the CoC,<sup>19</sup> the extent of protection afforded by such review is unclear. This will largely depend on how the NCLT and the NCLAT interpret it in future cases.

The issue regarding the treatment of the dues of operational creditors is particularly controversial due to the disenfranchisement of such operational creditors. Under the IBC, operational creditors are not allowed representation on the CoC and are accordingly unable to vote on any decision regarding the insolvency resolution process. This includes the approval of a resolution plan, which may alter the terms of their debt or extinguish it without any repayment. The ostensible safeguards under the IBC for operational creditors, i.e. the payment of at least the liquidation value and priority in repayment over financial creditors, are meaningless in practical terms. Given that the operational creditors are largely unsecured and companies are unable to repay their debts, if they have been admitted into insolvency, it is highly improbable that the liquidation value due to such operational creditors will be higher than zero in most cases. In any case, the hypothetical possibility of the liquidation value being higher than zero in certain instances cannot hide the reality that in a large majority of cases, operational creditors would not be entitled to any amounts. This effectively leaves the issue of their recovery to the generosity of the CoC and/or the resolution applicant.

In *Swiss Ribbons*, the Supreme Court specifically considered the issue of whether the lack of representation of the operational creditors on the CoC was violative of Article 14 of the Constitution (*protection from discrimination*).<sup>20</sup> The Supreme Court relied on the rationale for the exclusion of the operational creditors from the CoC based on the report of the Bankruptcy Law Reforms Committee (hereinafter “BLRC”),<sup>21</sup> which was the precursor to the IBC. The BLRC opined that financial creditors could evaluate the viability of a resolution plan, as they had trained employees for such purpose. On the other hand, operational creditors are involved only in recovering the amounts payable for their goods and services and are typically unable to assess the viability and feasibility of a business.<sup>22</sup> However, such a rationale seems tenuous. The BLRC assumes that merely because financial creditors may have the *ability* to analyse the viability and feasibility of a plan, they will indeed base their decision to approve or reject a plan primarily on the grounds of

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<sup>19</sup> See, for instance, *K. Sashidhar v. Indian Overseas Bank and others*, (2019) 12 SCC 150, ¶55.

<sup>20</sup> *Swiss Ribbons*, *supra* note 7.

<sup>21</sup> 1 The Bankruptcy Law Reforms Committee, Report: Rationale and Design (November 2005).

<sup>22</sup> 1 The Bankruptcy Law Reforms Committee, Report: Rationale and Design ¶4 (November 2005); *Swiss Ribbons*, *supra* note 7 at ¶75.

such viability and feasibility. However, the ultimate goal of any creditor, whether financial or operational, is to maximise recovery for itself. There is no incentive structure built into the IBC to facilitate a change in such a position and ensure that financial creditors do not act solely in their self-interest.

Another argument that may be advanced in support of the present framework under the IBC is that the resolution applicants being prospective acquirers of the corporate debtor, would require the cooperation of the operational creditors in running the business. Accordingly, it would be in the interests of such a resolution applicant to protect the interests of the operational creditors under the resolution plan. While on the face of it, this argument appears compelling, it would be applicable only in a limited number of cases, where the providers of the goods or services in question are not easily substitutable. Even in cases, where a certain operational creditor(s) may be particularly crucial to the business of the corporate debtor, it would be open to the resolution applicant to enter into appropriate agreements with such creditor(s) after the completion of the insolvency resolution process. Therefore, at the resolution plan stage, an applicant would be focused on making a compelling case, which would appeal to the financial creditors above all.

The distinction between secured and unsecured creditors has been maintained under the insolvency statutes in various jurisdictions such as the United States (hereinafter “US”) and the United Kingdom (hereinafter “UK”). However, under both jurisdictions, the ‘impaired’ classes of creditors have the right to vote on (and ordinarily even reject) any restructuring proposal that purports to alter their rights.<sup>23</sup>

For instance, under Chapter 11 of the US Bankruptcy Code, a committee of unsecured creditors is formed during the insolvency resolution process comprising of the twenty largest unsecured creditors of the debtor, who are willing to serve on the committee.<sup>24</sup> The purpose of such a committee is to ensure the representation of the interests of the unsecured creditors, who may be owed relatively small amounts and may not otherwise be given adequate consideration. The committee of unsecured creditors plays a vital and often determinative role in the restructuring process.<sup>25</sup> The committee has broad powers including participation in the formulation of a

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<sup>23</sup>See, 11 U.S.C. § 1126(c) read with 11 U.S.C. § 1129(8); (UK) Companies Act, 2006, § 899.

<sup>24</sup>11 U.S.C. § 1102.

<sup>25</sup>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).



restructuring plan, requesting the appointment of a trustee or examiner, or if the committee determines that it is in the best interest of the creditor to have a trustee liquidate the business, seek the conversion of the case to Chapter 7.<sup>26</sup>

Further, the confirmation of a reorganisation plan by the bankruptcy court ordinarily requires acceptance of such 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.<sup>27</sup> The ‘cram-down’ on dissenting creditors is permitted subject to the fulfilment of certain conditions (such as the plan being non-discriminatory and fair and equitable).<sup>28</sup> However, the risks and delays involved in such a ‘cram-down’ deter creditors from resorting to such tools and encourage settlement among the creditors.<sup>29</sup> Similarly, in the UK, the schemes of arrangement proposed, when the company is in administration (comparable to insolvency resolution under the IBC), require the approval of at least 50% in number, representing 75% in value, of each *class* of creditors under the (UK) Companies Act, 2006.<sup>30</sup>

In view of the above, the exclusion from the CoC and palpable marginalisation of operational creditors in the decision-making process under the IBC is not only contrary to the position in other jurisdictions but also appears to be based on questionable grounds and reasoning. The right of a class of creditors to vote on any proposal seeking to restructure their debt, adds a crucial element of procedural fairness to any final decision to extinguish the whole or part of their debt under any such proposal. The Indian position which deprives an entire class of creditors of such a right is patently unfair and lacks a sufficient basis. Accordingly, it is the view of the authors that the exclusion of operational creditors from the decision-making process under the IBC should be reconsidered and appropriate amendments should be introduced to allow for their participation in the CoC.

The authors’ view also finds support in the Legislative Guide on Insolvency Laws issued by the United Nations Commission on International Trade Law (hereinafter “UNCITRAL”). It states

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<sup>26</sup> 11 U.S.C. § 1103; 11 U.S.C. § 1104. A chapter 11 bankruptcy process is primarily for the reorganisation of debt while Chapter 7 is for liquidation of the corporate debtor.

<sup>27</sup> See, 11 U.S.C. § 1126(c) read with 11 U.S.C. § 1129(8).

<sup>28</sup> 11 U.S.C. § 1129.

<sup>29</sup> Charles D. Booth, *The Cramdown on Secured Creditors: An Impetus Towards Settlement*, 60 AM. BANKR. L.J. 69 (1986).

<sup>30</sup> Companies Act, 2006, § 899 (UK).

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.<sup>31</sup> The UNCITRAL also recognises that there may be a divergence of interests between different classes of creditors, including secured and unsecured creditors. Accordingly, it suggests the constitution of separate committees, where such interests are not adequately represented through the constitution of a single committee.<sup>32</sup>

Indeed, secured creditors would typically have priority over the claims of creditors including in the event of liquidation. This may justify the differential treatment of financial and operational creditors (who are typically unsecured). However, rather than leaving operational creditors bereft of any representation or recourse in respect of a process that purports to restructure their debt, a separate committee of operational creditors could be constituted. Any resolution plan could require the approval of such an operational creditors' committee albeit with a lower voting percentage than applicable in the case of financial creditors, for instance, 10% instead of the 66% required in the case of financial creditors.

The ability of the operational creditors as a class to block a resolution plan would provide critical leverage to such a class of creditors to ensure that their interests are taken into account by the resolution applicants as well as the financial creditors approving such a resolution plan. This is exemplified by the experience of the committee of unsecured creditors under the US Bankruptcy Code. Further, given that a resolution plan cannot discriminate among similarly placed creditors,<sup>33</sup> the approval of even a small percentage of operational creditors to a resolution plan would ensure that any benefit offered to, and found acceptable by such creditors would be available to the entire class of operational creditors.

The self-proclaimed object of the IBC is the “*maximization of value of assets*” of the corporate debtor and to “*balance the interests of all the stakeholders*”.<sup>34</sup> In this background, the utter disenfranchisement and disregard of the interests of the operational creditors appear to be unjustifiable. It is unfortunate that rather than considering solutions for the even-handed treatment

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<sup>31</sup> UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, LEGISLATIVE GUIDE ON INSOLVENCY LAWS ¶¶ 88-90 (2005).

<sup>32</sup> UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, LEGISLATIVE GUIDE ON INSOLVENCY LAWS ¶¶ 101-103 (2005).

<sup>33</sup> Swiss Ribbons, *supra* note 7 at ¶76.

<sup>34</sup> Insolvency and Bankruptcy Code, 2016, Preamble.

of operational creditors, the Parliament has sought to further curtail the rights of such creditors. This has been done by including an explanation that distribution in accordance with Section 30(2)(b) of the IBC would be deemed to “*fair and equitable*”.<sup>35</sup> Such a provision is evidently intended to preclude any challenge to the proposed treatment of the dues of operational creditors under a resolution plan. The haste of the Parliament in undoing the NCLAT order in *Essar Steel* and further disempowering operational creditors appears to be yet another instance of the Indian experience of knee-jerk reactions rather than formulating carefully reasoned positions.

### III. TREATMENT OF DISPUTED CLAIMS: AN UNRESOLVED PARADOX

Another aspect under the IBC having adverse implications for operational creditors, which has largely been ignored, is the treatment of ‘disputed’ claims in an insolvency resolution. Upon the commencement of the insolvency resolution process of a corporate debtor, a moratorium on the liabilities of the corporate debtor (including any monetary claims) comes into effect pursuant to Section 14 of the IBC.<sup>36</sup> ‘Claim’ is broadly defined under the IBC to include a right to payment, whether or not such a right is reduced to judgment, fixed, disputed, or undisputed. Creditors of the debtor are required to file their ‘claims’ along with the proof of such a claim with the resolution professional (hereinafter “RP”). The RP may admit or reject such a claim, and the creditors have the right to challenge the non-admission of a part or whole of their claim before the NCLT.

The UK and US insolvency legislations contain a similarly broad definition of ‘claims’. Courts in such jurisdictions have recognised the need to give the widest possible amplitude to such ‘claims’ provable in bankruptcy.<sup>37</sup> This is so that all the liabilities of the debtor may be comprehensively dealt with and discharged as a part of the insolvency resolution process. It also opens the doors for a debtor to get a fresh start, as non-provable debts would usually survive the insolvency resolution process.

In *Essar Steel*, the Supreme Court clarified that the role of the RP is limited to verifying and

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<sup>35</sup> *Supra* note 10.

<sup>36</sup> Insolvency and Bankruptcy Code, 2016, §14.

<sup>37</sup> *Nortel Companies and Others, Re*, [2013] 4 All ER 887, ¶ 93; *T&N Ltd and Ors, Re Insolvency Act 1986*, [2006] 3 All ER. 697, ¶¶ 35 and 46; *Sanchez v. Northwest Airlines, Inc.*, 659 F.3d 671, 675 and 688; *McSherry v. Trans World Airlines, Inc.*, 81 F.3d 739.

collating the claims of creditors. The RP cannot assume an *adjudicatory* function in respect of such claims. Considering the limited role of the RP, one issue that remains unaddressed is the treatment of ‘disputed’ claims, i.e. claims that were pending adjudication prior to the imposition of the moratorium under the IBC. The RP typically admits such disputed claims at a nominal value (say, INR 1) irrespective of the quantum of the claim to allow the participation of such creditors in the insolvency process. The admission of a claim by the RP is significant, as resolution plans ordinarily provide for the payment of only the admitted claims of creditors.

In this context, it is noteworthy that in *Essar Steel*, the NCLAT had assessed the ‘disputed’ claims of creditors on merits and admitted a large number of such claims. This increased the admitted liability of the corporate debtor by almost four times the original amount admitted by the RP.<sup>38</sup> This was intended to ensure that such disputed creditors could recover a proportionate share of the amounts proposed to be paid to other creditors of the same class under the resolution plan of ArcelorMittal. Creditors, whose claims could not be determined on merits by the NCLAT, were granted liberty to initiate (or continue) appropriate proceedings after the conclusion of the insolvency resolution process.<sup>39</sup> However, the Supreme Court set aside such admission of claims by the NCLAT. At the same time, the Supreme Court held that all disputed claims would stand extinguished and no proceedings for recovery of such claims could continue after the successful resolution of the corporate debtor.<sup>40</sup>

The ruling of the Supreme Court on extinguishment has brought much needed clarity to bidders, who may otherwise have been deterred from investing under the IBC on account of potentially crippling claims and litigation after they acquire the corporate debtor. However, this ruling has also gravely prejudiced the interests of creditors with disputed claims. The IBC does not contain any provision allowing the RP or the insolvency tribunals to estimate and thereby admit disputed claims. The ruling in *Essar Steel* does not provide any clarity on the substantive considerations to be taken into account by the RP or the Adjudicating Authority for the admission or rejection of disputed claims.

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<sup>38</sup> Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others (NCLAT order dated July 4, 2019 in Company Appeal (AT) (Ins.) No. 265 of 2019), ¶ 196.

<sup>39</sup> *Id.* at ¶ 221.

<sup>40</sup> Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others, (2020) (Supreme Court), *supra* note 3 at ¶¶ 67 and 102.

Despite such a lack of clarity, the ruling takes away the due process rights of such creditors to have their claims adjudicated by the courts ordinarily having jurisdiction. Accordingly, genuinely meritorious claims could stand discharged in insolvency without any payment or future recourse. In addition, frivolous disputes raised by the corporate debtor with regard to goods and services provided by the operational creditors could further destroy the already precarious standing of such creditors in the whole process.

Unlike the RP, the liquidator has been granted significantly broader powers to determine disputed claims under the IBC. The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 expressly provide that “*where the amount claimed by a claimant is not precise due to any contingency or any other reason, the liquidator shall make the best estimate of the amount of the claim based on the information available with him*”.<sup>41</sup> Pertinently, the IBC requires that a liquidator be a qualified resolution professional.<sup>42</sup> Clearly, the credentials of the liquidator are not the basis of the differential powers provided to the liquidator and the RP.

Such differential treatment of the disputed claims in an insolvency resolution and liquidation was likely based on the theoretical difference between the two frameworks. In the former, the company survives while in the latter, the company would be obliterated, and therefore, all claims must necessarily be dealt with one way or another. However, the Supreme Court’s ruling on the extinguishment of all claims in an insolvency resolution renders meaningless any such distinction. Paradoxically, the same creditors could recover more in liquidation than in an insolvency resolution. The impairment of the rights of the disputed creditors is all the more egregious given that such creditors are usually trade creditors. The general disenfranchisement of trade creditors under the IBC renders the extinguishment of their rights particularly inequitable.

The above issue may be resolved by an amendment to the IBC granting the RP the same power as a liquidator to ‘estimate’ disputed claims. The RP could take into account any Court orders passed in respect of such disputes (even if under appeal) to estimate such claims. The decision of the RP would be subject to review by the insolvency tribunals. A precedent for this may be found in the UK insolvency regime (the inspiration for the IBC), which grants the same powers to estimate

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<sup>41</sup> The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Regulation 25.

<sup>42</sup> Insolvency and Bankruptcy Code, 2016, §5(18).

claims with uncertain value to the office-holder. This power is concerning both the administration and the winding-up (comparable to an insolvency resolution and a liquidation process under the IBC respectively).<sup>43</sup> Alternatively, the insolvency tribunals could be granted first instance jurisdiction to estimate claims for their admission. Such a change would be similar to the jurisdiction of the US bankruptcy courts to estimate contingent or unliquidated claims to prevent undue delay to the case's administration.<sup>44</sup> Under either framework, a creditor's right to have a claim adjudicated would not disappear. It would merely be replaced by the right to have such a claim estimated and admitted by the RP or the insolvency tribunals.

The purpose of defining 'claims' broadly under the IBC<sup>45</sup> to include disputed claims is to enable their admission in insolvency. Moreover, one of the objectives of the IBC is to "*balance the interests of all stakeholders.*"<sup>46</sup> An amendment to the IBC to empower the RP or the insolvency tribunals to estimate and accordingly admit disputed claims, will better serve the scheme of the IBC and its stated objective.

## CONCLUSION

Despite being relatively nascent, the IBC has already succeeded in bringing about a substantial change in the existing culture of borrower impunity and lack of recourse for creditors plaguing the Indian banking sector. However, such success appears to be at the cost of the interests of other stakeholders, particularly operational creditors.

In *Essar Steel*, the Supreme Court upheld the constitutionality of the amendments to the IBC, which grant the CoC considerable powers to decide matters related to the distribution of funds among creditors under a resolution plan. In a marked shift from its previous position, the Supreme Court found a stark difference in recovery between the operational creditors and the financial creditors to be 'equitable'. The Supreme Court has attempted to afford some protection to operational creditors by requiring the CoC to 'take into account' the interests of such creditors when

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<sup>43</sup> The Insolvency (England and Wales) Rules 2016, Rule 14.14.

<sup>44</sup> 11 U.S.C. §502(c).

<sup>45</sup> Insolvency and Bankruptcy Code, 2016, §3(6).

<sup>46</sup> Insolvency and Bankruptcy Code, 2016, Preamble.

exercising its commercial wisdom. It has also empowered the NCLT to ensure such compliance.<sup>47</sup> However, the extent of such protection remains questionable given that the ‘commercial wisdom’ of the CoC continues to retain primacy.

The *Essar Steel* ruling strikes at the heart of the stated aim of the IBC to “*balance the interests of all stakeholders*”.<sup>48</sup> A resolution process would necessarily entail a compromise on the part of the creditors in respect of their dues. This would obliterate all the rights and remedies in respect of the claims of the operational creditors (including disputed claims). Such an obliteration of rights without any due process would not serve either the stated objectives of the IBC or the larger public interest.

In the view of the authors, potential solutions to ensure more equitable treatment of operational creditors need to be considered by both the legislature as well as the insolvency tribunals and courts. The present framework, which leaves the manner of treatment of dues of operational creditors to the CoC comprising of financial creditors with an evident conflict of interest, is patently inadequate. One possible solution is to allow for the participation of operational creditors in the decision-making process including for the approval of a resolution plan in line with international practice. This would add an element of fairness to any haircut on their dues under a resolution plan and incentivise resolution applicants and financial creditors to ensure equitable treatment of their dues.

Lastly, the IBC and the Supreme Court disregard the interests of creditors with ‘disputed’ claims by failing to provide any mechanism to quantify and admit such claims in an insolvency resolution process. In the view of the authors, the RP should be given the same powers as a liquidator to ‘estimate’ disputed claims or the NCLT should be conferred with the first instance jurisdiction to assess such claims. Such provisions for the estimation and admission of disputed debt would also be more in accord with the scheme and objectives of the IBC and in keeping with the practice followed in other jurisdictions.

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<sup>47</sup> Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and others, (2020) (Supreme Court), *supra* note 3.

<sup>48</sup> Insolvency and Bankruptcy Code, 2016, Preamble.