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Position of Financial and Operational Creditors under the Insolvency Law in India: An Analysis

By Mayank Jain and Omansh Gupta

ABSTRACT

The Insolvency and Bankruptcy Code, 2016 ("Code") was enacted to consolidate and amend the law relating to the reorganization and insolvency of corporate persons, partnership firms, and individual firms. The object of this Code is to facilitate the resolution of corporate bankruptcy in an inexpensive, time-bound manner and to eliminate any hurdles and lacunas in previous legislations. Moreover, it aims to balance the interest of all the stakeholders. The Code has introduced new and distinct concepts of 'financial creditors' and 'operational creditors', such classification not being present in the Companies Act, 2013. Since the introduction of the Code, there have been various challenges concerning the above classification of creditors in respect of their respective claims against the corporate debtor. As per the Code, the financial creditors have been given priority over operational creditors. This creates a conflict of interest between financial and operational creditors. Constructive interpretation by the judiciary coupled with recent amendments to the Code has helped in solving many of these problems but the position is not absolutely clear. In this paper, we shall aim to provide a comprehensive view of the above issue by analyzing various provisions of the Code and judicial pronouncements.

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 was enacted to consolidate and amend the laws pertaining to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time-bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interest of all the stakeholders such as creditors, employees, etc. It also aims to alter the order of priority of payment of Government dues and also to establish a Board (i.e Insolvency and Bankruptcy Board of India). The Code provides creditors/applicant with a mechanism to initiate an insolvency resolution process by filing an application to the Adjudicating Authority (i.e the National Company Law Tribunal or commonly referred to as "NCLT") in the event the corporate debtor is unable to fulfill its obligations (i.e to pay its debts). After examination of the application, the NCLT, upon being satisfied that there exists a dispute between the parties arising out of a default on part of the debtor for nonpayment of the money, may admit the application. Post admission of the application, the insolvency process commences. The application can be moved primarily by three persons- Financial Creditor, Operational Creditor and Corporate Applicant. *Financial creditors* are those persons to whom a "financial debt" (i.e purely a money debt along with interest) is owed and includes persons to whom such debt is legally assigned or transferred to. *Operational creditors* are those persons to whom an "operational debt" (i.e money receivable against delivery of goods and services) is owed and includes persons to whom such debt is legally assigned or transferred to. Initially, when the Code was enacted it provided priority to financial creditors over operational creditors which created numerous controversies as there was no intelligible differentia on the basis of which such priority was given. Although the Code provided the manner of distribution of assets of corporate debtor (commonly known as the "waterfall provision") yet the amount assigned to each stakeholder was not fixed, as a result of which virtually nothing was realized by the operational creditors and most of it went in the hands of financial creditors. Recent amendments to the Code and various judgments of Courts/Tribunals have given various interpretations and views on the above issue. The same is being discussed further in the paper.

POSITION PRIOR TO THE CODE

Prior to the enactment of the Code, various statutes existed which governed the law on insolvency. These include SICA (Special Provisions Act), 1985, RDDBFI Act, 1993, SARFAESI Act, 2002, and other restructuring mechanisms such as CDR and SDR. These are discussed below-

SICA-

The object of the Sick Industries Companies Act (SICA) was to (a) make special provisions for timely detection of potentially sick industrial companies, (b) to establish a Board (i.e Board of Industrial and Financial Construction "BIFR") to decide issues with regard to the viability of such companies and (c) to provide effective measures which need to be taken with respect to such companies and enforcement of these in a timely manner. Under the Act, a sick industrial company meant an industrial company having being registered for a period of not less than five years which has at the end of any financial year accumulated losses equal to or more than its entire net worth. As per the provisions of the Act, when an industrial company became "sick", the Board of Directors of the company were required to refer BIFR within 60 days from the date of finalization of its duly audited accounts at the end of which it has become "sick". Pursuant to this, the BIFR made an inquiry into the working of the company and after being satisfied that the company has become "sick" pass an order giving powers to an Operating Agency to prepare a scheme providing for such measures in relation to the company. Such agency would then within 90 days from the date of the order, come up with various measures in such schemes such as reconstruction, management, amalgamation, alteration in Memorandum of Association (MoA), etc. The BIFR would then examine the scheme and after suitable modifications (if any) publish a "draft scheme" in the daily newspaper and invite objections from the company, operating agency, and other interested parties. After considering all the facts and circumstances of the case, the BIFR, if satisfied that the company would not be able to meet its financial obligations, would give a finding/opinion that the company is wound up and forward such opinion to the concerned High Court. The major reason why SICA failed was that it followed a balance sheet approach rather than a prospective cash flow approach. It took a reasonably long time for the company's net worth to erode and serious liquidity issues were never addressed. Moreover, the Act did not define the terms of financial and operational creditors. It merely talked about secured and unsecured creditors which created ambiguity in case the company was wound up and had to make payment to the creditors.

RDDBFI Act-

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI) aimed to provide for expeditious adjudication and recovery of debts due to banks and financial institutions by Tribunals such as Debt Recovery Tribunal (DRT) and Debt Recovery Appellate Tribunal (DRAT) established for such purpose. By the Amendment Act of 2016, the scope of this Act was extended to "insolvency resolution and bankruptcy of individuals and partnership firms". Sub-section (4) of section 1 of the Act provides that the provisions of the Act shall not apply where the amount of debt due to any bank or financial institution or to a consortium of banks or financial institutions is less than ten lakh rupees (or such amount, being not less than one lakh rupees), as the Central Government may by notification specify. In other words, claims of more than ten lakh rupees are to be adjudicated upon. As per the Amendment Act of 2016, the term "secured creditor" was introduced under Section 2 (la). It included any bank or financial institution or a group of banks or financial institution in whose favor security interest (i.e right, title and interest of any kind whatsoever upon property, created in favor of such bank or financial institution and included any mortgage, charge, hypothecation, and assignment). The amendment also added Section 31B which gave priority to secured creditors over all other debts and Government dues including revenues, taxes, cess, and rates. Further, the explanation to section 31B clarified that in cases of insolvency or bankruptcy proceedings being pending in respect of secured assets of the borrower under the IBC, priority to secured creditors in payment of debt shall be subject to the provisions of the Code. From the above, it can be seen that the Act did not provide any classification with respect to financial or operational creditors. It simply classified creditors on the basis of secured and unsecured. Also, there is no definition provided for unsecured creditors under the Act which created ambiguity as to who shall be unsecured and how much will they be entitled to recover after the secured creditors are paid.

SARFAESI Act-

Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI) was established to "enforce" a security interest created in favour of a secured creditor. The term secured creditor has the same meaning as provided under the RDDBFI Act. Section 13 of the Act deals with the enforcement of security interest under which the secured creditor shall give due notice to the borrower to discharge his liability within 60 days from the date of receipt of the notice, failing which the creditor can take actions such as (i) taking possession of the secured assets (i.e NPAs) of the borrower, (ii) taking over management of the business of the borrower, (iii) appoint any person to manage the secured assets of the borrower. The major drawback of this Act was that no rights were given to the unsecured creditors. Only secured creditors were included and there was ambiguity as to the interests of unsecured creditors. Furthermore, there was no minimum limit or trigger amount to enforce the security interest. All that was required that the borrower owed to the secured creditor and interest was created in favour of the latter.

Other mechanisms (CDR and SDR) –

Corporate Debt Restructuring (CDR) was introduced for the first time in 2001 for implementation by the banks. It was limited only to the banks and financial institutions that had a cumulative exposure not exceeding 10 crore rupees. CDR was a non-statutory voluntary system or an understanding/agreement entered into by the creditors and borrowers for restructuring the debt of the borrower and come up with a solution to sustain the business of the corporate debtor. Strategic Debt Restructuring (SDR) was announced by the Reserve Bank of India in 2015. The main aim of the scheme was to change the management of the company in order to deal with the stressed assets. Desired results could not be achieved through such schemes of restructuring and the number of cases actually resolved were very few in number. Furthermore, unsecured creditors were left out of the ambit of such schemes, and only secured creditors were included.

PROVISIONS OF IBC AS ORIGINALLY STOOD IN 2016

Before we tackle the concepts of financial and operational creditors let us understand the meaning of the term "creditor" as defined in the Code. As per Section 3(10), a creditor means a person to whom a debt is owed and includes- (i) financial creditor, (ii) operational creditor, (iii) secured creditor, (iv) unsecured creditor and (v) a decree-holder. Section 5(7) defines a *financial creditor* to be a person to whom a financial debt (which means a debt along with interest disbursed against the consideration for the time value of money, such as money borrowed against payment of interest) is owed. Such debt is purely monetary. Sub-clause (20) of the same defines an *operational creditor* as a person to whom an operational debt (i.e a claim in respect of the provision of goods and services) is owed.

Section 21(2) gave powers to financial creditors with regard to the formation of a Committee of Creditors (CoC) and operational creditors were left out of the ambit of this section. However proviso to sub-clause (8) provided that in case the corporate debtor did not have any financial creditors, it was for the Board to decide as to who shall be part of the CoC and what functions such persons are required to perform. Hence there was ambiguity as to the role of operational creditors in the insolvency process. The provision clearly favoured the financial creditors.

Section 30 (1)(b) provided for repayment of the amount due to operational creditors in the manner the Board deemed fit but which was not to be less than as provided under Section 53 in the event of liquidation of the corporate debtor. Section 53 provided for the order of priority in which the assets of the corporate debtor were to be distributed. Sub-clause (d) of the section covered unsecured financial creditors and sub-clause (f) contained "any remaining debts" which covered operational creditors. This clearly showed that financial creditors were to be paid before the operational creditors.

A bare reading of the above provisions makes it clear that operational creditors were placed below the financial creditors. The former were not included in CoC and were included only if the latter were not present. Operational creditors did not have any say in the insolvency resolution process and were virtually excluded. A long list of persons mentioned under Section 53 made it practically very difficult for the operational creditors (being third from the bottom of the list) to realise their money since most of it went first to workmen, employees, secured creditors, financial creditors. Operational creditors virtually received nothing. This created ambiguity as to the position of operational creditors in the insolvency and liquidation process which led to numerous clarifications and amendments to the Code. These are further discussed in the paper.

IBBI REGULATIONS WITH RESPECT TO FINANCIAL AND OPERATIONAL CREDITORS

Regulation 7 of IBBI (Insolvency Resolution Process of Corporate Persons) Regulations 2016 ("CIRP 2016") as amended in 2018 talks about the *claims by operational creditors* and says that a person claiming to be an operational creditor, other than workman or employee of the corporate debtor, is required to submit its claim with proof to the interim resolution professional in person, by post or by electronic means in Form B of the Schedule and such person may submit supplementary documents or clarifications in support of the claim before the constitution of the committee. The existence of debt which is due to the operational creditor under the Regulation can be proved on the basis of the records available with an information utility or other relevant documents viz. a contract for the supply of goods and services with the corporate debtor; an invoice demanding payment for the goods and services supplied to the corporate debtor; order of a court or tribunal that has adjudicated upon the non-payment of a debt, or financial accounts.

Regulation 8 (1) CIRP 2016 talks about *claims by financial creditors* and says that a person who claims to be a financial creditor, other than a financial creditor belonging to a class of creditors, is required to submit a claim with proof to the interim resolution professional in electronic form in Form C of the Schedule and also such person may submit supplementary documents or clarifications in support of the claim before the constitution of the committee. Clause (2) states that the existence of debt due to the financial creditor can be proved on the basis of the records available with an information utility or other relevant documents, including a financial contract supported by financial statements as evidence of the debt, a record evidencing that the amounts committed by the financial creditor to the corporate debtor under a facility have been drawn by the corporate debtor, financial statements showing that the debt has not been paid; or an order of a court or tribunal that has adjudicated upon the non-payment of a debt.

Regulation 16 provides a committee consisting of operational creditors only in a situation where there are no financial creditors. The former shall have the rights and obligations similar to that of a committee comprising of financial creditors.

Regulation 38(1) states that a resolution plan should mandatorily provide that the amount due to operational creditors under a resolution plan shall be given priority in payment over financial creditors. There is no minimum amount prescribed for payment to operational creditors under the amended Regulations. However, Sub-section 30 (2) (b) of the Code requires in all events that the resolution professional confirms that the resolution plan provides for the payment of debts of operational creditors which should 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 of the Code. Therefore, the minimum prescribed amount due to operational creditors remains unchanged and the interests of operational creditors is to the extent of the liquidation value of the amounts due to them, remain protected under the Code. The main change brought about by this amendment is that, now all payments due to operational creditors as contemplated under a resolution plan and not just the minimum prescribed amount, have to be made in priority to financial creditors.

RECENT AMENDMENTS AND CLARIFICATIONS

In the past, there were many discrepancies as to whom should be given priority in various claims, and also there were a lot of roadblocks and gaps which lead to a time-consuming process and hindrances in the smooth corporate insolvency resolution process. Recently, the government on the recommendation of experts and various judgments of the courts and tribunals have decided to make certain amendments in the Code and Regulations in order to streamline and smoothen the working of the resolution process. Some of the amendments through notifications are mentioned below: -

A strict timeline of 330 (three hundred and thirty) days been set to complete Insolvency Resolution Process which earlier was 270 (two hundred and seventy) days.

The IBC (Second Amendment) Act, 2018 inserted an explanation to the definition of financial debt, where any amount raised from allottees under a real estate project including home buyers will be considered as financial debt and home buyers who were earlier considered as "other creditors" will now be treated as "financial creditors" and can be a part of the Committee of Creditors (CoC).

Regulation 38 of CIRP 2016 states that operational creditors will be paid on priority over financial creditors under a resolution plan. This payout mechanism is in direct conflict with the waterfall provision (i.e Section 53) of the Code which gives priority to financial creditors over operational.

As per Notification dated March 24, 2020, Section 4 of the Code has been amended whereby the minimum amount of default has been increased to Rs 1 crore (earlier it stood as Rs. 1(one) lakh).

In view of the prevailing COVID-19 pandemic, IBC Amendment Ordinance 2020 has been introduced inserting a new provision (Section 10A) which states that no application for initiation of corporate resolution process shall be filed for defaults arising on or after March 25, 2020, for a period of 6 (six) months or such further period (which will be notified) not exceeding 1 year from such date, provided that no application shall ever be filed during the said period.

RULINGS OF TRIBUNALS AND COURTS

In ***Binani Industries Limited v. Bank of Baroda & Another***, [1]the Committee of Creditors (CoC) approved a resolution plan in which financial and operational creditors were given differential

[1] Company Appeal(AT) (Insolvency) No. 82 of 2018

payments, which was later on challenged by some creditors and contended that they were not treated equally as financial creditors. The NCLAT considered the objective of IBC which states that the resolution and its purpose are for maximizing the value of assets of the corporate debtor and thereby for all the creditors. It is not the maximization of value for a stakeholder or a set of stakeholders such as creditors and is to promote entrepreneurship, availability of credit, and balance the interests. The objectives of the report of the Bankruptcy Law Reform Committee (BLRC), were also considered and stated that the liabilities of all creditors who are not a part of the CoC must also be considered in the resolution plan. The terms of the existing liabilities can also be modified by financial creditors and not by other creditors as they might take the risk of delay in payment for the better future prospectus. Thus, *financial creditors can take their dues in future, while operational creditors need to be paid immediately*. A creditor cannot maximize its own interests in view of the moratorium. So, if any type of creditor is given preferential treatment, then the other types of creditors might face the threat of getting disappeared from the market which will be against the objective of the credit market. The Insolvency and Bankruptcy Code aims to balance the interests of all stakeholders and does not maximise value for financial creditors. Therefore, the payment dues of operational creditors must be given similar treatment as compared to the due of the financial creditors. Thus, NCLAT held that any Resolution Plan which is discriminatory against one or other financial creditors or the operational creditor, then such a plan can be held to be against the provisions of the I&B Code. Therefore, *it is necessary to treat financial creditors and operational creditors* ***equally*** *for the purpose of maximisation of assets for corporate debtors*. Thus the Tribunal ordered the revision of the resolution plan in which equal treatment for the claim should be given.

In ***Central Bank of India Vs. Resolution Professional of the Sirpur Paper Mills Ltd. &Ors***.[2], the provisions of Regulation 38 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 were observed and it was ruled as follow :

> *"From the aforesaid provisions of I&B Code it is clear that the Board may make regulation but it should be consistent with the I&B Code and rules made therein (by Central Government) to carry out the provisions of the Code. Therefore, we hold that the provisions made by the Board cannot override the provisions of I&B*

See also: 2018 SCC ONLINE NCLAT 521

[2] Company Appeal (AT) (Insolvency) No. 526 of 2018

Code nor it can be inconsistent with the Code. Clause (b) and (c) of Regulation 38(1) being inconsistent with the provisions of I&B Code, and the legislators having not made any discrimination between the same set of group such as 'Financial Creditor' or 'Operational Creditor', Board by its Regulation cannot mandate that the Resolution Plan should provide liquidation value to the 'Operational Creditors' (clause (b) of regulation 38(1)) or liquidation value to the dissenting Financial Creditors (clause (c) of regulation 38(1)). Such regulation being against Section 240(1) cannot be taken into consideration and any Resolution Plan which provides liquidation value to the 'Operational Creditor(s)' or liquidation value to the dissenting 'Financial Creditor(s)' in view of clause (b) and (c) of Regulation 38(1), without any other reason to discriminate between two set of creditors similarly situated such as 'Financial Creditors' or the 'Operational Creditors', cannot be approved being illegal."

In ***Swiss Ribbons vs Union of India***[3], Section 7 of the Code was challenged for the fact that there is no intelligible differentia in the classification of financial and the operational creditor in the Code and emphasis is being given to the object to be achieved by the Code viz. insolvency resolution, if that is possible, if not, then ultimately, liquidation. It was contended that only financial creditors were being placed in the CoC, thus it amounts to discrimination under Article 14 of the Indian Constitution. The Supreme Court, later on, upheld the Constitutional validity, stating in Para 28 of the judgment which talked about the differentiation between financial creditors and operational creditors, that:

"Most importantly, financial creditors are, from the very beginning, involved with assessing the viability of the corporate debtor. They can, and therefore do, engage in restructuring of the loan as well as re-organization of the corporate debtor's business when there is financial stress, which are things operational creditors do not and cannot do. Thus, preserving the corporate debtor as a going concern, while ensuring maximum recovery for all creditors being the objective of the Code, financial creditors are clearly different from operational creditors and therefore, there is obviously an intelligible differentia between the two which has a direct relation to the objects sought to be achieved by the Code."

It was thus held by the Court that the classification of creditors on the basis of financial creditors and operational creditors is neither arbitrary nor discriminatory and does not violate the provisions of Art 14 of the Indian Constitution. Court also considered the BLRC report which provided for

[3] Company Appeal (AT) (Insolvency) No. 526 of 2018

classification between financial creditors and operational creditors. The Supreme Court in para 27 also distinguish between the Financial Creditor and the Operational Creditor stating:

> *"Financial Creditor generally lend finance on a term loan or working capital that enables the corporate debtor to set up the business. On the other hand, contracts with operational creditors are relatable to supply of goods and services in the operation of business. Financial contracts generally involve large sums of money. By way of contrast, operational contracts have dues whose quantum is generally less. In the running of a business, operational creditors can be many as opposed to financial creditors, who lend finance for the set up or working of business"*

It was also noted by the Court that the operational creditor or their representatives can participate in the CoC if the amounts of their aggregate dues are not less than ten percent of the debt. NCLTs, should also while forming a resolution plan, check whether operational creditors are treated similarly as the financial creditors and if not, then such plans should be either modified or rejected in order to protect the rights of the operational creditors. The Court also incorporated the principle of fair, equal, and just treatment to all creditors and now it is required in Regulation 38 that a resolution applicant must state how the resolution plan meets the interests of operational creditors. Once the resolution proceedings commence then the proceedings become proceedings *in rem* and it cannot be terminated by a single individual creditor.

In ***Arcelor Mittal India Private limited vs Satish Kumar Gupta and others***[4] (known as Essar Steel case) the National Company Law Appellate Tribunal (NCLAT) ruled that operational creditors of Essar Steel should be treated at par with financial creditors at the time of settling claims. NCLAT chairperson Justice S.J. Mukhopadhaya instead of rejecting the plan, ordered to modify the plan to satisfy the needs of both classes of creditors. The tribunal ruled that lenders and operational creditors would get 60.7% of their outstanding claims and proportionately share the ₹42,000 crores that Arcelor Mittal has offered to pay for the debt-laden firm, which in rupee terms entails payment of ₹30,030 crores to financial creditors and ₹11,969 crores to operational creditors. Thus, giving equal treatment to both classes of creditors and also following the doctrine of equity.

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[4] Civil Appeal No. 9582 OF 2018

In *Committee of Creditors of Essar Steel v. Satish Kumar Gupta*[5] , the Supreme Court has held that the rights of financial creditors will prevail over the operational creditors in the distribution of the funds received from the insolvency proceeds. The court held that the financial creditors are the primary investors and capita-providers for the company whereas, operational creditors are secondary beneficiaries from the amount lent by the financial creditors. Furthermore, the court also set to clear out the lacunas in light of the unsecured lending. Analyzing the debt proportionality ratio of the creditors, the court opined that the priority of operational creditors over financial creditors did not mean the same percentage of debt recovery. The point of law is questioned on equitable treatment and not on equal treatment.

ANALYSIS

When the Code was introduced, there was an understanding that the Financial Creditors have preference over Operational Creditors in terms of the distribution of assets and this understanding arose from Section 53 of the Code. The issue in question regarding the preference to operational or financial creditor arose when the NCLAT pronounced its decision in ***Binani Industries Limited*** wherein it held that the Insolvency and Bankruptcy Code and the regulations framed by IBBI does not prescribe any difference in treatment with respect to the assets between Operational and Financial Creditors. This decision was overruled in ***Swiss Ribbons*** wherein the Court upheld the validity of Section 53 of the Code and also reasoned the classification between Financial and Operational Creditors as intelligible differentia. It is pertinent here to construe both the judgments in harmony as both relate to different aspects leading to the same objective. Intelligible differentia is one element and payment of dues on preference is another. The Financial and Operational Creditors can be classified but when it comes to payment of dues they should be treated on equal footing. In a recent judgment pronounced on 4th July 2019 by NCLAT in ***Standard Chartered Bank v. Satish Kumar Gupta, R.P of Essar Steel Limited & Others***, the NCLAT noted that the distribution of debts to the Financial Creditors and Operational Creditors during the resolution process cannot be equated with the distribution during the liquidation. What seems to be one of the most prevalent principles throughout the order, is upholding the spirit of equitable treatment of the creditors. The initial resolution plan gives indications of arbitrary discrimination, not only between the financial and

[5] Civil Appeal 8766-67 of 2019

operational creditors but also between the various sub-classes from amongst the same category of creditors. While one class of the financial creditors was proposed to get a hefty 92.5% of their dues, the Operational creditors on the other hand were either nominally assessed at Re. 1/- or were proposed to get 0% of their dues. This plan when put before NCLT, Ahmedabad, was approved with the condition that Operational creditors who have dues below Rs. 1 Crore must be paid in full. It is for this very reason that the aggrieved Operational Creditors filed an appeal before NCLAT for rejection of the Resolution Plan proposed by AMIPL. In the resolution process, the Resolution applicant cannot demand distribution of the amount as per Section 53. The NCLAT held that Sub-clause (b) of sub-section (2) of Section 30 of the Code mandates that the Resolution Plan must provide for the payment of the debts of Operational Creditors in such manner as may be prescribed 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. This means that the Operational Creditors should not be paid less than the amount they could have received in the event of liquidation out of the asset of the Corporate Debtor. It does not mean that they should not be provided an amount more than the amount they could have received in the event of a liquidation which otherwise amounts to discrimination. Hence, the decision clearly lays down that both the classes of creditors should be treated the same based on the principles of equitability. It is pertinent to note here that the term "equitable" does not mean "equal". It only means the procedure followed to determine the payment dues to both the class of creditors should be the same. The ruling also makes extremely interesting observations about the relevance or irrelevance of Section 53 to the framing or prioritization of claims in case of a resolution, initiating a completely new line of thinking. What was also discussed in this judgment was the equitable treatment of similarly situated creditors. Financial Creditors form the part of the CoC and the fate of all classes of creditors rests in their hand. So, it is the responsibility of the CoC to act in good faith and in the interests of all the creditors. It was observed that the Financial and Operational Creditors are in a position of conflict when it comes to the distribution of assets as most of the assets would fall in the hands of Financial Creditors.

NCLAT held that Section 53 cannot be made applicable to distribution among stakeholders in CIRP and the applicability of Section 53 during liquidation and CIRP should not be construed the same. Instead of providing solutions to the issue, this decision raged the issue further. An amendment dated August 6, 2019, has endeavored to bring clarity and by virtue of the same section 30 of the

Code has been amended whereby it offers more power and rights to the operational creditors and lays down definite amounts payable to operational creditors.

CONCLUSION

Even after a plethora of judgments and amendments, there is still a room of doubt as to preference among the two classes of creditors. The latest IBC amendment is silent regarding the same thus creating room for doubt. There is an urgent need to have a settled position of law in this aspect. The reasoning of preference to Financial Creditors was that these creditors provide financial assistance to companies and hence their role in the economy is more significant as compared to operational creditors as was held **in *Swiss Ribbons* and *Committee of Creditors vs Satish Kumar***. It is now, a settled position of law that Section 53 which deals with the order of distribution of debts is not applicable to Resolution plans. There is an issue as to the difference in priorities of distribution in insolvency and liquidation. Insolvency laws are based on the principles of distributive justice and distinguishing the distribution in light of insolvency and liquidation is an overwhelming violation of distributive justice. This is one aspect on which the Indian Judiciary should bring some clarity upon. The judgment in Arcelor Mittal and the recent amendments have not directly addressed the issue but have laid provisions for the determination of the amount paid to the Operational Creditors. Though the judgment states that the two class of creditors should be given similar treatment, but there is still a difference in the way they receive debts and in the computation of the amounts payable to them. In spite of the judgments noting that the two classes of creditors should be treated the same, there are still differences that are leading to misinterpretation and ambiguity which requires further clarifications from the legislature.