

Classification of creditors under IBC

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Insolvency and Bankruptcy Code

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The debate on the categorisation of particular creditors as financial or operational or not even falling under those categories is not novel. The issue of categorisation has been persisting since the inception of the Insolvency and Bankruptcy Code, 2016 (IBC) because of the underlying scheme of the IBC. This categorisation is by no means irrelevant, at least in the context of the IBC. The Scheme under the IBC is such that all the creditors prefer to fall under at least one of these two categories, the financial creditor category being the more preferred one.

The operational creditors are still on a backfoot compared to the financial creditors. This is because being categorised as an operational creditor does not guarantee any recovery. However, these creditors are still better placed than others, such as the involuntary creditors who will not even have a chance to recover anything unless prescribed by the IBC itself.

Moreover, after the recent judgement of the Hon'ble Supreme Court in Vidarbha Industries Power Limited v. Axis Bank Limited, a distinction has been created between accepting the claims of financial creditors and operational creditors. It has been held that the acceptance of claims of the financial creditors is discretionary while for the operational creditors, it is mandatory.

This may seem to contradict the debt and default model that the IBC works on, that is, if it is proved that there was a debt and that was defaulted upon, then the creditors can make an application to the Adjudicating Authority. The discretion is not boundless and is limited, since the facts of the case do not allow its application in all cases. But it definitely has stirred up a controversy because, on the face of it, this puts a dent in the position of the financial creditors. The same has been true for the homebuyers being categorised as financial creditors—this was because the allottees were a vulnerable class and were supposed to be given the most protected status under the IBC.

The controversy has not been limited to whether a particular creditor is a financial or operational creditor, but in fact, whether the creditor falls in any of the categories. For instance, the controversy about unpaid license fees being regarded as an operational debt is still pending before the Supreme Court.

In Jaipur Trade Expocentre Private Limited v. M/s Metro Jet Airways Training Private Limited, the full bench National Company Law Appellate Tribunal [NCLAT] has held that license fee should be considered as operational debt. By pronouncing this judgement, the NCLAT overruled its judgement in M Ravindranath Reddy v. G Kishan. The license agreement in Jaipur Trade Expocentre Private Limited was entered into by the parties to

run an educational institution. According to NCLAT, the Adjudicating Authority erred in holding that the services under Section 5(21) would not include a license fee agreement of such nature.

Before this, in another case, Promila Taneja vs. Surendri Design Pvt. Ltd., the NCLAT held that the definition of services under the Consumer Protection Act and Goods and Services Act cannot be imported for the purposes of the classification of a debt under IBC. This judgement was distinguished from and not adopted in the Jaipur Trade Expo centre case. Moreover, the judgement in the Promila Taneja case has been appealed before the Supreme Court and is currently pending over there.

There have been many such debates previously—the debate on licensing fees is just a recent one.

The essential point of classification of debt and consequently the creditors is the order of priorities and strength of the creditors in meetings and otherwise. We should not brush off the classification as irrelevant or having only little significance. This is because of many reasons apart from the ones stated above.

As we are adopting new methods of resolution of debts such as mediation, and pre-packs within the scheme of IBC, the roles and rights of creditors are serious and pertinent questions. Any classification which is not desirable can lead to adverse consequences like significant cram downs once a majority of the class of particular creditors, mostly the financial creditors, has approved a plan or any scheme or pre-packs.

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