

## Abstract

The IBC marked a landmark reform in India's insolvency regime. It aims to consolidate and streamline insolvency and bankruptcy proceedings, enable timely corporate resolution, maximise value of assets and balance interests of various stakeholders. [Wikipedia+2Global Restructuring Review+2](#) However, despite the inclusive objective, operational creditors (vendors, suppliers, employees, government dues) face structural disadvantages in the resolution and liquidation process: unclear definitions, restricted rights, lower priority of recovery, and inconsistent judicial interpretation. This paper examines the legal framework governing operational creditors under IBC, identifies the deficiencies (particularly lack of clarity in definition, weaker rights, discriminatory treatment), and proposes targeted reforms (clearer definitions, enhanced rights in Committee of Creditors, priority re-ordering, streamlined adjudication, improved enforcement) to ensure that operational creditors are not unfairly denied legitimate dues. The aim is to contribute to policy-discussion on necessary amendments to the IBC (and where applicable other related Acts) to make the insolvency regime more equitable for the operational creditor class.

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## Introduction

Indian insolvency law underwent profound reform with the enactment of the IBC in 2016. The IBC fundamentally changed the landscape by creating a time-bound process for corporate insolvency resolution, establishing the Insolvency and Bankruptcy Board of India (IBBI) and adjudicatory forums (National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT)), and by categorising creditors into "financial creditors" and "operational creditors". [Wikipedia](#) The objective was to achieve "maximisation of value of assets" and "balance the interests of all stakeholders" including creditors, debtors, employees and the government. [IBC](#) [Law+1](#)

In practice, however, operational creditors frequently claim that they are disadvantaged: many legitimate dues remain unpaid even after high-court or Supreme Court orders; their rights to meaningful participation in the insolvency process are limited; and the ambiguity in definition of "operational debt" and "operational creditor" leads to litigation and inconsistent outcomes. Given that many small suppliers, service providers, and MSME units depend on timely payments, the systemic impact is significant: non-payment may trigger secondary insolvencies and value-erosion. Accordingly, clarifying and strengthening the operational creditor regime is both a matter of justice and economic efficiency.

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## Problem Statement

The central issues addressed in this paper are:

1. **Lack of clarity in definition:** The definitions of “operational debt” and “operational creditor” under IBC (Sections 5(20), 5(21)) leave ambiguity and have led to disputes. [IBC Law+1](#)
2. **Differential treatment of operational vs financial creditors:** Operational creditors are excluded from key decision-making rights (e.g., membership/voting in CoC) and face lower recovery priority, which may undermine their ability to get legitimate dues. [Live Law+1](#)
3. **Judicial inconsistency and practical losses:** Operational creditors often receive negligible or no recovery despite incurring genuine operational exposure. The legal recourse is complicated by delays, procedural hurdles, and limited rights. [tranzission.in+1](#)
4. **Economic and stakeholder impact:** For MSMEs and suppliers reliant on receivables, delays or denial of payment via insolvency proceedings causes cascading stress, undermines credit ecosystem and the objective of value maximisation is compromised.
5. **Reform gap:** although criticism of the IBC’s operational creditor regime has been raised in academic and professional literature, there is a need for concrete reform proposals addressing definition clarity, process rights, priority of payment and enforcement mechanisms.

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## Legal Framework: Operational Creditors under IBC

### Definition

Under Section 5(20) IBC: “operational creditor” means a person to whom operational debt is owed, including by way of provision of goods or services, OR a person to whom such debt has been legally assigned or transferred. [IBC Law+1](#)

Under Section 5(21) IBC: “operational debt” means a claim in respect of the provision of goods or services including employment, OR a debt for the repayment of dues arising under any law for the time being in force and payable to Central/State Government or a local authority. [Live Law+1](#)

### Key Distinctions and Rights

- Only a “financial creditor” (under Section 5(7)) has the right to initiate Corporate Insolvency Resolution Process (CIRP) under certain conditions, though operational creditors also have this right (subject to certain prerequisites). [NLSIU Repository+1](#)
- In the Committee of Creditors (CoC) that steers the resolution, only financial creditors (and their representatives) participate and vote in decisions under

Section 21. Operational creditors do not have a vote unless in limited scenarios (e.g., no financial creditors exist). [IBC Law+1](#)

- Section 30(2)(b) IBC provides that under a resolution plan, the operational creditors must be paid at least the higher of: (i) what they would receive in liquidation under Section 53, or (ii) what they would receive under the plan if distributed under Section 53. [Live Law](#)
- Section 53 provides order of priority in liquidation: secured creditors, costs of CIRP, workmen dues, employee dues, unsecured creditors (including financial/operational) and then government dues, etc. Operational creditors thus often rank below some classes and obtain limited recovery. [IBC Law](#)

## **Judicial and Practical Issues**

Multiple analyses point out that although the framework appears to protect operational creditors, in practice the protections are weak: recovery is minimal, procedural hurdles abound, definitions are litigated, and operational creditors are often marginalised in the process. [Live Law](#)

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## **Identified Deficiencies & Challenges**

Based on the legal framework and practical experience, the following key deficiencies emerge:

### **1. Ambiguous definition of “operational debt” and “operational creditor”**

- It is often unclear whether a particular claim constitutes an “operational debt” (goods/services) or falls outside the definition (for example, mixed transactions, supply of goods and finance, delays in payment). This leads to litigation and delay.
- The secondary reference in the definition to “dues arising under any law ... payable to Government” is broad but vague in application (which laws qualify, what is the exact nature of “dues”?)
- Because of definitional ambiguity, operational creditors may be denied recognition or treated as financial creditors or vice versa, affecting rights and recovery.

### **2. Disadvantaged rights relative to financial creditors**

- Operational creditors cannot vote in the CoC, meaning they have no direct say in the resolution plan that may affect their recovery. This reduces their negotiating power. [IBC Law](#)
- They often find that the resolution plan or liquidation distribution gives them lower priority, meaning even if they are acknowledged, their recovery is lower.

### **3. Low recovery and value erosion**

- In practical terms, it's observed that operational creditors receive “nil or negligible” recovery in many cases. [Live Law](#)
- Delay in initiation or process further erodes value of assets, so even when recognised, the amount available to distribute is lower. [Bank for International Settlements](#)

### **4. Procedural and litigation burdens**

- Operational creditors must often issue demand notices (under Section 8) and adhere to procedural steps, which adds cost and time.
- Delays in NCLT/NCLAT jurisdiction, ambiguous classification, appeals and stay orders lead to protracted litigation.

### **5. Priority ordering during liquidation unfavourable**

- Under Section 53, operational creditors (unsecured) are placed after workmen/employee dues and certain other classes, thereby limiting their share. [IBC Law](#)
- This undermines the intent of “balance the interests of all stakeholders” since operational creditors are major stakeholders (suppliers, employees, service providers) but their recovery is systematically disadvantaged.

### **6. Impact on MSMEs and supply-chain**

- Many operational creditors are MSMEs or smaller entities which cannot afford prolonged non-payment or litigation. Non-recovery causes business failure and undermines ecosystem.
- The current model disincentivises suppliers from exposing goods/services without upfront payment, thereby reducing credit availability in the supply-chain.

### **7. Lack of transparency and accountability in resolution plans**

- Because operational creditors lack voting rights and seats at the table, plans may be structured favouring financial creditors without sufficient regard to operational creditor interests.
  - Monitoring and enforcement of the guarantee in Section 30(2)(b) is weak in practice. [Live Law](#)
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## Proposed Reforms for Operational Creditor Protection

In view of these deficiencies, this paper proposes the following reforms to be considered for amendment of IBC and associated regulations:

### A. Clarify and tighten the definitions

1. **Redefine “operational debt”** to provide clearer categories: e.g., distinguish supply of goods, supply of services, employment obligations, statutory dues, and other operational obligations. Provide examples.
2. **Define “operational creditor”** more precisely: e.g., include suppliers, contractors, employees, service providers, statutory-dues creditors, with thresholds or special provisions for MSMEs.
3. Introduce **safe-harbour rules** for mixed transactions: where there is a hybrid of goods/service supply and financial accommodation (e.g., supplier extends credit), provide a guideline for classification (financial vs operational).
4. Insert **guidance or regulatory schedules** clarifying which “dues arising under any law” qualify (taxes, statutory fees, environment levy, municipal dues etc). This avoids debates and litigation.

### B. Enhance rights of operational creditors in the resolution process

1. Grant operational creditors **voting rights in the CoC**, at least in proportion to their admitted claim (or via a minimum threshold). Alternatively, create a **sub-committee of operational creditors** who can meaningfully participate when they constitute a significant part of debt.
2. Mandate that **resolution plans explicitly address operational creditor claims** separately and provide transparency about how claims were valued, how their interests are taken into account, and how pay-out will occur.
3. Strengthen the guarantee under Section 30(2)(b) by introducing **minimum recovery ratios** for operational creditors or providing that the plan must pay operational creditors **no less than a specified percentage (e.g., 30-40 %) of their admitted claim** unless there is full justification and court approval for lower.
4. Allow **priority or pari passu treatment** of operational creditors in certain categories (e.g., employee dues, supplier dues) relative to unsecured financial creditors when value-erosion occurs, to prevent perverse outcomes where financial creditors recover fully and operational creditors nothing.

### C. Re-order distribution priority in liquidation

1. Amend Section 53 to **raise the priority of operational creditors**, especially SMEs, service providers and employees, ahead of certain unsecured financial creditors, subject to a specified cap.
2. Introduce **special fast-track liquidation provisions** for cases where operational claims exceed a threshold and delay would destroy value – thereby enabling quicker payment to suppliers whose business depends on it.
3. Provide for “**operational creditor fund**” or **ring-fenced asset share** in liquidation to ensure a fixed share of realizations is reserved for operational claims before distribution to unsecured financial creditors.

### D. Procedural simplification and cost-effective enforcement

1. Simplify demand-notice requirement (Section 8) for operational creditors: for example, allow simplified electronic notice and shorter timelines, especially for MSME suppliers.
2. Introduce **expedited adjudication/jurisdiction** for operational creditor claims: perhaps via specialised benches or fast-track courts for smaller claims, to reduce cost and delay.
3. Provide **cost-cap or waiver** for operational creditors (especially MSMEs) in insolvency applications and appeals, to reduce burden of litigation.
4. Enhance transparency and monitoring by IBBI/regulator so that operational creditor claims and realization outcomes are published (e.g., percentage recovery for operational vs financial creditors) – which will inform policy and foster accountability.

### E. Strengthen regulatory oversight and mechanism for avoidance and preferential transactions

1. Require that in avoidance transactions (e.g., under Sections 43-50, 66 IBC) the interests of operational creditors be explicitly considered—especially where payments were diverted to financial creditors ahead of operational creditors.
2. Provide for **penalties or disgorgement** where promoters/financial creditors are found to have structured repayments that disadvantage operational creditors.
3. Encourage the IBBI to issue **guidelines** for resolution practitioners and adjudicating forums on assessment of preferential transactions adversely affecting operational creditors.

## F. Encourage use of pre-pack and MSME-specific mechanisms

Given that many operational creditors are MSMEs:

1. Expand and incentivise use of the “Pre-Pack Insolvency Resolution Process (PPIRP)” for MSME corporate debtors and their supplier ecosystems, so the process is quicker, cheaper, and participative, and supplier claims (operational creditors) are addressed early. [Bank for International Settlements](#)
2. Provide that in the PPIRP model, operational creditors form a separate class or committee with enhanced participatory rights, given their critical role in supply chains.
3. Introduce **awareness-campaigns** and capacity-building for operational creditors (especially MSMEs) about their rights under IBC, timelines, requirements and best practices.

## G. Judicial and Regulatory Clarifications

1. The Supreme Court / NCLAT / NCLT should issue **authoritative guidance** or interpretation regarding key grey zones in operational creditor classification (mixed transactions, assignment of claims, supply-chain liabilities, government dues) to reduce litigation.
2. IBBI should publish **data on recovery outcomes** disaggregated by creditor class (operational vs. financial) and size of creditor, so policy makers can assess performance and calibrate reforms.
3. Government should consider a **review committee** (e.g., under Ministry of Corporate Affairs) to evaluate operational creditor outcomes after a defined interval (say every 3 years) and recommend periodic amendments.

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## Practical Implications & Benefits

- **For Suppliers/MSMEs:** Better protection of receivables; improved cash-flow; reduced risk of secondary insolvencies among suppliers; more predictable risk of dealing with distressed corporate debtors.
- **For the Insolvency Ecosystem:** Enhanced fairness and stakeholder confidence; improved supply-chain stability; better value preservation where suppliers keep operating and business continuity is maintained.
- **For Credit Markets & Economy:** A more balanced regime may reduce cost of credit for operational creditors; improve trust in contracts; reduce latent risk of vendor- insolvencies triggered by large corporate defaults.
- **For Policy & Governance:** Strengthening the operational creditor side aligns with IBC’s stated objective of balancing stakeholder interests; improved transparency and data-driven oversight will improve regulatory credibility.

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## Challenges in Implementation

- **Opposition from financial creditor lobby:** Financial creditors may resist rewriting priority or giving enhanced rights to operational creditors as this may reduce their recovery.
- **Complexity of mixed transactions:** Many supplier arrangements include credit terms, factoring, goods and services mixture. Sorting classification will require careful drafting and may increase litigation initially.
- **Administrative burden:** Stricter protections may require additional monitoring, data capture, and regulatory oversight, adding cost for IBBI/NCLT.
- **Delay risk:** Any reform that makes resolution process more complex or gives more parties a vote may risk delay – which defeats the IBC's aim of time-bound resolution. Thus, reforms must be designed to enhance rights without undermining speed.
- **Data availability:** Currently data on operational creditor recovery is limited; improving disclosure will take time and systemic effort.

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## Conclusion

The IBC was a milestone in India's insolvency reform, but the treatment of operational creditors still poses significant challenges. The lack of definitional clarity, weaker process rights, less favourable priority, and practical recovery shortfalls mean that many operational creditors (often smaller suppliers, contractors, employees) are left exposed. Given their critical role in the economy and supply chains, this is both a fairness issue and a structural risk to value-preservation in insolvency. Meaningful reform is therefore necessary: clearer definitions, enhanced rights in resolution process, improved priority in liquidation, procedural simplification, better transparency and data-driven monitoring. Such reforms would improve stakeholder balance, enhance the credibility of the insolvency regime, and safeguard the interests of operational creditors while keeping the core aim of timely resolution intact. In the context of Maharashtra (or other states) where many MSMEs and service providers operate, these reforms will have local relevance and may help in devising state-specific outreach, sensitisation and capacity-building programmes for operational creditors. As an active professional in the finance/regulatory advisors network, advocating for these reforms (through industry associations, commentary to government, representation via bodies such as WIRC of ICAI / other professional forums) could contribute to better outcomes for operational creditors in future.

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## References

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