International Research Journal of Management and Commerce
ISSN: (2348-9766)
Impact Factor 8.098 Volume 12, Issue 06, June 2025
©Association of Academic Researchers and Faculties (AARF)
www.aarf.asia, **Email** : editoraarf@gmail.com

Secured Creditors and Corporate Winding-Up under the Insolvency and Bankruptcy Code, 2016

Dr. Shruti Vijay Vaghela
Assistant Professor of Law
Maharashtra National Law University, Nagpur

Abstract

The study examines the role and rights of secured creditors in corporate winding-up under the Insolvency and Bankruptcy Code, 2016 (IBC). Secured creditors, holding collateral-backed claims, play a pivotal role in insolvency proceedings by influencing both resolution and liquidation outcomes. The research explores statutory provisions under Sections 52 and 53 of the IBC, which empower secured creditors to enforce or relinquish their security interests. It also analyses judicial interpretations, that have shaped their legal standing. Through a doctrinal approach supported by comparative insights, the paper highlights practical challenges such as conflicts with other recovery laws, valuation issues, and procedural delays. The study concludes with policy suggestions to harmonise laws, enhance transparency, and strengthen enforcement mechanisms, ensuring a balanced and efficient insolvency framework for secured creditors in India.

Keywords: Secured Creditors, Insolvency and Bankruptcy Code, 2016, Winding-Up, Liquidation, Waterfall Mechanism, Insolvency Resolution, Creditor Rights, Corporate Insolvency.

Introduction

The concept of secured creditors and their role in corporate insolvency is central to understanding the liquidation process under the Insolvency and Bankruptcy Code, 2016 (IBC). Secured creditors, who lend against collateral, hold a privileged position compared to unsecured creditors, as their claims are backed by tangible security. However, their rights are subject to legal frameworks that govern corporate insolvency and winding-up procedures.

Corporate insolvency and liquidation proceedings are designed to ensure that a company's assets are distributed in a fair and orderly manner when it can no longer meet its financial obligations. While the IBC primarily focuses on the resolution of distressed companies through the Corporate Insolvency Resolution Process (CIRP), in cases where resolution is not possible, the liquidation process is initiated. At this stage, the status and rights of secured creditors become particularly significant.

A secured creditor is defined under Section 3(30) of the IBC, 2016 as a creditor who has a security interest over the debtor's property. This interest provides them with a legal right to recover their dues by selling the collateral in the event of default. Secured creditors may include banks, financial institutions, bondholders, and other lenders who extend credit against tangible or intangible assets.

Secured creditors play a vital role in corporate financing by providing capital to businesses under the assurance that, in case of default, they will have the first claim over the secured asset. This assurance enables companies to secure loans at lower interest rates, as lenders perceive a lower risk in lending against collateralized assets. However, in insolvency scenarios, their rights to enforce security must be balanced against the broader interest of other stakeholders, including unsecured creditors, employees, and government authorities.

Winding up, also known as liquidation, is the process of bringing a company's operations to an end, selling its assets, and distributing the proceeds among creditors and shareholders. Historically, corporate winding-up in India was governed by the Companies Act, 1956, and later, the Companies Act, 2013. However, the enactment of the Insolvency and Bankruptcy Code, 2016, brought a significant shift in the insolvency regime by providing a comprehensive legal framework for corporate insolvency, restructuring, and liquidation.

Under the Insolvency and Bankruptcy Code, 2016 (IBC), corporate insolvency proceedings comprise two distinct but interconnected phases: the Corporate Insolvency Resolution Process (CIRP) and Liquidation. CIRP represents a time-bound resolution effort aimed at reviving financially distressed companies by facilitating restructuring or sale of business as a going concern. If the CIRP fails to yield a viable resolution plan within the stipulated timeframe (typically 180 to 270 days), the company proceeds to the liquidation phase, wherein its assets are sold off to repay creditors in an orderly manner.

Within the liquidation process, secured creditors hold a dual role and are accorded critical options. They may choose to enforce their security interest independently outside the liquidation estate, thereby recovering dues directly from the collateralized assets. Alternatively, they may opt to relinquish their security interest, allowing the secured assets to become part of the liquidation estate and claim their dues from the proceeds distributed under the IBC's prescribed waterfall mechanism. This dual pathway empowers secured creditors with flexibility to maximize recovery while balancing the interests of other stakeholders in the insolvency framework. Such provisions significantly enhance secured creditors' rights compared to earlier insolvency laws, ensuring greater certainty and control in the winding-up process.

Research Objectives

The research objectives include:

- To understand the legal framework governing the rights of secured creditors in winding-up petitions.
- To assess the interplay between secured creditors' rights and the Insolvency and Bankruptcy Code (IBC), 2016.
- To examine judicial trends and landmark cases that have shaped the status of secured creditors in liquidation.
- To analyze potential conflicts between secured and unsecured creditors in winding-up proceedings.
- To explore the practical implications of winding-up petitions filed by secured creditors.

Literature Review

Alur (2022)[1] provides a comparative analysis of company winding-up procedures across the UK, USA, and India, highlighting the unique features of India's IBC and its emphasis on secured creditor rights during liquidation.

Brinkmann (2008)[2] examines the position of secured creditors in insolvency under European law, emphasizing the importance of their preferential rights and the impact on recovery outcomes.

Katti and Venkatesh (2022)[3] critically analyze the waterfall mechanism of the IBC, discussing the priority and hierarchy of payments in corporate insolvency with a focus on secured creditors' claims.

Mann (2022)[4] explores the pattern and rationale behind secured credit in commercial law, highlighting how secured creditors influence restructuring and liquidation decisions under insolvency regimes.

Singh (2021)[5] focuses on the liquidation waterfall mechanism under the IBC, detailing how secured creditors are prioritized in distributions and the procedural safeguards provided to them.

Research Methodology

This study will employ a doctrinal research approach, focusing on primary and secondary legal sources, including statutes, case laws, and legal commentaries. A comparative study will be undertaken to assess how other jurisdictions address the rights of secured creditors in winding-up proceedings, offering a broader perspective on best practices and challenges. If feasible, empirical research may be conducted through interviews with insolvency professionals, legal experts, and corporate practitioners to gain practical insights into the challenges faced by secured creditors in

[1]Alur, N.A., 2022. Comparative Analysis of Winding up of a Company: Perspectives in UK, USA & India. Issue 2 Indian JL & Legal Rsch., 4, p.1.

[2] Brinkmann, M., 2008. The position of secured creditors in insolvency. European Company and Financial Law Review, 5.

[3]Katti, A. and Venkatesh, N., 2022. A Critical and Comparative Analysis of the'Waterfall Mechanism'Provided under the Insolvency and Bankruptcy Code of 2016. Issue 6 Indian JL & Legal Rsch., 4, p.1.

[4]Mann, R.J., 2022. Explaining the pattern of secured credit. In The Creation and Interpretation of Commercial Law (pp. 347-405). Routledge.

[5]Singh, S., 2021. Liquidation Waterfall Mechanism under Insolvency & Bankruptcy Code, 2016. *Indian JL & Legal Rsch.*, *2*, p.1.

enforcing their claims. The study will rely on qualitative analysis to evaluate the legal, judicial, and policy aspects of secured creditors' petitions for winding up.

Scope and Limitations

The scope of this research will be limited to Indian insolvency law, particularly focusing on the Insolvency and Bankruptcy Code, 2016. It will also incorporate relevant international comparisons where applicable to provide a broader understanding of secured creditors' rights. However, the study will not provide an exhaustive analysis of insolvency laws across all jurisdictions, nor will it include a quantitative assessment of winding-up cases. The research will primarily focus on legal principles, judicial interpretations, and policy considerations rather than empirical data on corporate insolvency trends.

Concept of Secured Creditors

Secured creditors play a fundamental role in corporate finance and insolvency proceedings. Their legal rights and protections stem from their ability to enforce claims against specific assets of a debtor, making them crucial stakeholders in insolvency cases. This section delves into the definition of secured creditors, their classification, their rights and priorities, and the key legal provisions governing their claims under Indian law, particularly under the Insolvency and Bankruptcy Code (IBC), 2016.[6]

Definition of Secured Creditors

The Insolvency and Bankruptcy Code, 2016 defines a secured creditor under Section 3(30) as:

"A creditor in favor of whom security interest is created."

A security interest, as defined under Section 3(31) of the IBC, refers to any right, title, or interest created in favor of a secured creditor by way of a mortgage, charge, pledge, or hypothecation on property, assets, or undertakings of a corporate debtor. This provides secured creditors with preferential rights over other creditors, ensuring they can recover their dues through the sale or enforcement of secured assets.

In contrast, unsecured creditors do not hold any collateral and rely solely on contractual rights to claim their debts, making them subordinate to secured creditors in liquidation proceedings.[7]

---

[6] Brinkmann, M., 2008. The position of secured creditors in insolvency. *European Company and Financial Law Review*, *5*.
[7] Wood, R.J., 2010. The Definition of Secured Creditor in Insolvency Law. *Banking & Finance Law Review*, *25*, p.341.

Types of Secured Creditors

Secured creditors can be broadly categorized based on the type of security interest they hold and the nature of their claims.[8]

(A) Classification Based on Type of Security Interest

Fixed Charge Creditors – These creditors hold a specific charge over a defined asset, such as real estate, machinery, or intellectual property. The company cannot dispose of these assets without their consent.

Floating Charge Creditors – These creditors hold a general charge over assets that change in the ordinary course of business, such as inventory, accounts receivables, and raw materials. The charge "crystallizes" into a fixed charge upon insolvency or default.

Pledge Holders – These creditors take physical possession of assets like stocks, gold, or warehouse receipts as security for the loan.

Hypothecation Creditors – These creditors have a charge over assets, but the debtor retains possession and usage rights until default occurs.

(B) Classification Based on Type of Secured Debt

Financial Secured Creditors – Typically banks, non-banking financial companies (NBFCs), and institutional lenders who extend term loans or revolving credit secured by assets.

Operational Secured Creditors – Suppliers, landlords, and service providers who extend credit with security, such as landlords requiring security deposits.

Debenture Holders – Bondholders or institutions that lend money through secured debentures backed by company assets.

Government as Secured Creditor – In some cases, the government holds security interest in corporate debtors, such as unpaid taxes secured by statutory liens.

Rights and Priorities of Secured Creditors

Secured creditors have distinct rights that allow them to protect their financial interests, particularly during insolvency or liquidation.[9]

---

[8] Mann, R.J., 2022. Explaining the pattern of secured credit. In *The Creation and Interpretation of Commercial Law* (pp. 347-405). Routledge.
[9] Jackson, T.H. and Kronman, A.T., 1978. Secured financing and priorities among creditors. *Yale LJ, 88,* p.1143.

(A) Right to Enforce Security Interest: Under Section 52 of the IBC, secured creditors can enforce their security interest independently and recover their dues outside the liquidation estate. They can also choose to relinquish their security interest and claim their dues from the proceeds of asset liquidation under Section 53 (the "Waterfall Mechanism").

(B) Right to Participate in the Corporate Insolvency Resolution Process (CIRP): Secured creditors, especially financial creditors, form the Committee of Creditors (CoC), which decides on resolution plans under the CIRP. They have voting rights based on the value of their claims, ensuring their role in approving or rejecting resolution plans.

(C) Priority in Distribution of Proceeds: If secured creditors relinquish their security, they are ranked second in the distribution hierarchy under Section 53 of the IBC, just below insolvency resolution costs and workmen's dues. If they enforce their security interest, they can recover directly but must refund any surplus to the liquidation estate.

(D) Right to Interest and Additional Dues: Secured creditors are entitled to receive the full value of their secured claims, including interest, penalties, and costs incurred in recovery efforts.

(E) Protection Against Preferential and Fraudulent Transactions: If a corporate debtor unlawfully transfers assets to defraud creditors, secured creditors can challenge such transfers under Sections 43–51 of the IBC.[10]

Difference Between Secured and Unsecured Creditors

Aspect	**Secured Creditors**	**Unsecured Creditors**
Collateral	Holds security interest (mortgage, pledge, charge)	No security backing
Priority in Insolvency	Higher priority in liquidation under Section 53	Lower priority; paid after secured creditors
Voting Rights in CIRP	Have voting rights in CoC (if financial creditors)	Operational creditors have limited voting rights

[10] Rights of Secured Creditors under the Insolvency and Bankruptcy Code, 2016. (2020, June 30). *IBCLaw.in*. Retrieved from https://ibclaw.in/rights-of-secured-creditors-under-the-insolvency-and-bankruptcy-code-2016-by-advocate-sabhay-choudhary/ Visited on 5 December, 2024

Right to Enforce Security	Can enforce security outside liquidation estate (Section 52)	No such right; must wait for liquidation proceeds
Risk Exposure	Lower risk due to collateral	Higher risk due to lack of security

Key Legal Provisions Governing Secured Creditors

(A) The Insolvency and Bankruptcy Code, 2016: Section 3(30) & Section 3(31): Defines secured creditors and security interest; Section 52: Grants secured creditors the right to enforce security outside liquidation; Section 53: Governs priority of payment in liquidation.; Section 13 & 14: Moratorium applies to enforcement of security during CIRP.

(B) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002: Allows banks and financial institutions to recover dues from secured assets without court intervention. Often used alongside IBC for quicker asset recovery.

(C) The Companies Act, 2013: Provides for the registration of charges on company assets, ensuring secured creditors have priority over unregistered claims.

Judicial Interpretations on Secured Creditors' Rights

Swiss Ribbons Pvt. Ltd. v. Union of India[11]– The Supreme Court upheld the constitutional validity of the Insolvency and Bankruptcy Code (IBC), including its classification between financial creditors and operational creditors. This distinction was justified on the grounds of differing roles, capacities, and risk profiles in lending and corporate finance. By recognising financial creditors as primarily responsible for assessing viability and restructuring, the Court reinforced their primacy in the Committee of Creditors (CoC) and indirectly strengthened the position of secured creditors The ruling underscored that prioritising financial creditors in resolution processes serves the IBC's objective of timely and effective insolvency resolution.[12]

ICICI Bank Ltd. v. Sidco Leathers Ltd.[13]– The Supreme Court confirmed that a secured creditor's rights over pledged or mortgaged assets take precedence over unsecured claims, even in winding-up proceedings. This case cemented the principle that the security interest is enforceable

[11] (2019) 3 S.C.R. 535, 2019 INSC 95

[12] Samy, A.K., 2022. Analysis of Swiss Ribbons (P) Ltd. and Ors. vs Union of India (2019) SCC Online SC 73. *Part 2 Indian J. Integrated Rsch. L.*, *2*, p.1; Khandelwal, H., 2019. Determining the Constitutionality of IBC-Swiss Ribbons Pvt. Ltd. v/s Union of India, 2019. *Ltd. v/s Union of India*.

[13] (2006) 10 SCC 452

independently, allowing secured creditors to realise their dues from specific collateral without being diluted by the general pool of creditors. It reinforced the doctrine that commercial certainty in lending depends upon the sanctity of security arrangements, thus preserving creditor confidence in financial transactions.[14]

Innoventive Industries Ltd. v. ICICI Bank[15]– The Supreme Court clarified that the IBC provides a complete and overriding framework for resolving corporate insolvency, superseding other recovery mechanisms such as SARFAESI when insolvency proceedings are initiated. Secured creditors, while retaining their substantive rights under other laws, must adhere to the procedural discipline of the IBC in order to ensure collective resolution rather than fragmented enforcement. This case established the IBC's dominance as the uniform code for insolvency, preventing parallel proceedings and thereby promoting coherence, timeliness, and fairness in the treatment of secured and other creditors.Evolution of Corporate Winding-Up Laws in India

The legal framework governing corporate winding-up in India has undergone significant transformation over the years. From the Companies Act, 1956 to the Companies Act, 2013, and finally, to the Insolvency and Bankruptcy Code (IBC), 2016, the approach towards corporate insolvency has shifted from a court-driven process to a creditor-driven mechanism. This evolution reflects the growing need for a more efficient, time-bound, and structured insolvency resolution system that balances the interests of all stakeholders, including secured creditors.

Early Corporate Winding-Up Laws in India

The legal framework for corporate winding-up in India has its origins in British colonial laws. The concept of insolvency was initially governed by statutes such as:

Indian Companies Act, 1913 – Modeled after the English Companies Act, this law provided for corporate liquidation but was largely procedural and lacked efficiency.

Provincial Insolvency Act, 1920 – Applied to individuals and partnerships but had implications for company directors in case of personal liability.

Presidency Towns Insolvency Act, 1909 – Governed insolvency in major British-era presidencies like Bombay, Calcutta, and Madras.

---

[14] Katti, A. and Venkatesh, N., 2022. A Critical and Comparative Analysis of the'Waterfall Mechanism'Provided under the Insolvency and Bankruptcy Code of 2016. *Issue 6 Indian JL & Legal Rsch.*, *4*, p.1.
[15] (2017) 9 SCC 783

These laws were primarily court-driven, lacked a structured priority mechanism for creditors, and were ineffective in resolving corporate insolvencies in a timely manner.[16]

Companies Act, 1956: The First Comprehensive Framework

The Companies Act, 1956, marked a significant step toward formalizing the process of corporate winding-up in India. It classified winding-up into three types:

- Compulsory Winding-Up by Court – Initiated when a company was unable to pay debts, acted against public interest, or engaged in fraudulent activities.
- Voluntary Winding-Up – Could be initiated by the company itself through a special resolution.
- Winding-Up Under Supervision of the Court – Applied in cases where voluntary liquidation required judicial oversight.

Under this regime, the rights of secured creditors were recognized, but there was no clear priority structure, leading to prolonged litigation and delays. Courts played a central role in the process, making liquidation inefficient and time-consuming.

Companies Act, 2013: A Shift Towards Creditor Protection

The **Companies Act, 2013**, replaced the 1956 Act and introduced reforms aimed at enhancing corporate governance and creditor protection. It introduced:

- Tribunal-Based Liquidation – The power to initiate winding-up was shifted from High Courts to the National Company Law Tribunal (NCLT).
- Grounds for Winding-Up (Section 271-272) – Allowed creditors to file for winding-up in case of non-payment of debts.
- Role of Liquidator (Section 275-277) – Introduced the concept of an official liquidator who managed asset distribution among creditors.

Despite these reforms, liquidation remained a lengthy process, and creditors, including secured lenders, faced difficulties in asset recovery. This led to the enactment of the Insolvency and Bankruptcy Code, 2016, which introduced a modern and structured approach to corporate insolvency and liquidation.

[16] Singhal, M. and Goel, K., 2021. Comparative Analysis of Winding up of a Company: Perspectives in UK, USA & India. *Nyaayshastra L. Rev.*, *2*, p.1.

The Insolvency and Bankruptcy Code (IBC), 2016: A Paradigm Shift

The IBC, 2016, marked a revolutionary shift by consolidating multiple insolvency laws into a single, comprehensive framework. It aimed to:

- Reduce the time for insolvency resolution (180-270 days) to prevent value erosion.
- Provide secured creditors with more rights over collateral enforcement.
- Replace the court-driven approach with a creditor-led insolvency process.[17]

Key Features of IBC Affecting Winding-Up and Secured Creditors

- Corporate Insolvency Resolution Process (CIRP) – Companies in distress are given a chance to restructure before facing liquidation.
- Liquidation Process (Section 33-54) – If CIRP fails, liquidation follows, and secured creditors decide whether to enforce security interest or claim from proceeds.
- Moratorium Period (Section 14) – Prevents legal actions against the corporate debtor during resolution.
- Waterfall Mechanism (Section 53) – Establishes priority order for debt repayment, securing creditors' claims.[18]

Under the IBC, secured creditors have the option to either:

- Enforce their security outside the liquidation estate (Section 52), or
- Relinquish their security interest and receive proceeds under the waterfall mechanism (Section 53).
- This flexibility strengthens their position compared to previous insolvency laws.

Comparison Between Different Winding-Up Regimes

Aspect	Companies Act, 1956	Companies Act, 2013	Insolvency and Bankruptcy Code, 2016
Process	Court-driven, lengthy	Tribunal-driven, moderate efficiency	Creditor-driven, time-bound

[17] Understanding the IBC: Winding-up and Liquidation. (2021). *IBBI*. Retrieved from https://ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf Visited on 5 December, 2024

[18] Winding-up priority to secured creditors. (2024, December 9). *IBCLaw.in*. Retrieved from https://ibclaw.in/ca-subject/winding-up-priority-to-secured-creditors/ Visited on 5 December, 2024

Role of Secured Creditors	Limited rights, had to wait for court decisions	Some improvements, but delays persisted	Significant autonomy, can enforce security directly
Time Taken	10+ years in many cases	5-7 years on average	270-day maximum (if CIRP succeeds)
Moratorium	Not applicable	Not clearly defined	Section 14 moratorium prevents asset depletion
Distribution of Assets	No clear priority	Improved but lacked efficiency	Section 53 waterfall mechanism ensures fairness

The shift from a **court-driven** to a **creditor-driven** insolvency process under IBC has significantly improved the enforcement of secured creditors' rights.

Impact of IBC on Secured Creditors and Future Reforms

The IBC has significantly improved asset recovery rates and the efficiency of the liquidation process. However, some challenges remain:

- Conflicts with Other Laws – Overlaps with SARFAESI Act, 2002, and RDB Act, 1993, sometimes create confusion regarding the enforcement of security.
- Delays in Resolution – Despite time-bound provisions, many cases exceed the 270-day limit due to litigation.
- Need for Greater Clarity in Section 52 – Some ambiguities remain regarding the process of secured creditors' enforcement outside liquidation.
- Proposed Reforms
- Stronger Enforcement Mechanisms – Faster resolution of secured creditors' claims through specialized commercial courts.
- Harmonization with Other Laws – Clearer guidelines on interactions between IBC, SARFAESI, and other recovery laws.
- Digital Asset Tracking – Implementing technology for better asset monitoring and liquidation.

Rights and Priorities of Secured Creditors in Winding-Up: Section 52 and the

Waterfall Mechanism Under IBC

The rights and priorities of secured creditors play a crucial role in corporate insolvency and liquidation proceedings. Secured creditors, unlike unsecured creditors, hold a security interest over specific assets of the corporate debtor, which provides them with preferential treatment during asset recovery. The Insolvency and Bankruptcy Code (IBC), 2016, revolutionized the framework governing corporate insolvency by introducing a time-bound and structured liquidation process that enhances the rights of secured creditors.[19]

This section analyzes the rights of secured creditors under Section 52 of the IBC, their options in liquidation, and their position in the waterfall mechanism under Section 53, which determines the order of distribution of proceeds. Additionally, judicial interpretations and practical challenges in enforcing these rights will be examined.[20]

Rights of Secured Creditors Under Section 52 of the IBC

Section 52 of the IBC grants secured creditors two options during liquidation:

1. To enforce their security interest outside the liquidation process.
2. To relinquish their security interest and claim their dues from the proceeds of liquidation.

Option 1: Enforcing Security Interest Outside Liquidation

Secured creditors can choose to enforce their security **outside the liquidation process**, provided they comply with the following conditions:

- Inform the liquidator of their decision to enforce security (Section 52(2)).
- Recover their dues from the secured asset through legal mechanisms such as the SARFAESI Act, 2002 or the Recovery of Debts and Bankruptcy Act, 1993.
- If the recovered amount is insufficient, claim the remaining debt from the liquidation estate as an unsecured creditor (Section 52(9)).
- If the recovered amount exceeds the debt owed, the surplus must be returned to the liquidation estate (Section 52(7)).

This option benefits secured creditors by allowing them to recover their dues without being dependent on the broader liquidation process. However, it also imposes risks-if the security is

[19] Mohan, M.P., 2023. Environmental Claims under Indian Insolvency Law: Concepts and Challenges. *Tex. Int'l LJ*, *59*, p.105.
[20] Singh, S., 2021. Liquidation Waterfall Mechanism under Insolvency & Bankruptcy Code, 2016. *Indian JL & Legal Rsch.*, *2*, p.1.

undervalued or difficult to liquidate, creditors may recover less than they would have under the general liquidation process.

Option 2: Relinquishing Security Interest and Claiming Under Liquidation Process

If secured creditors choose not to enforce their security interest separately, they must relinquish their secured asset to the liquidator and become part of the general liquidation process. In this scenario:

- The asset forms part of the liquidation estate.
- The secured creditor receives proceeds based on the waterfall mechanism under Section 53.
- The priority of distribution is based on their ranking in the liquidation hierarchy.[21]

This option benefits secured creditors when the asset is difficult to sell, as the liquidator is responsible for disposing of it and distributing proceeds accordingly. However, creditors lose control over the asset's realization value and timing.

Priority of Secured Creditors in the Waterfall Mechanism (Section 53)

Section 53 of the IBC establishes the waterfall mechanism, which defines the order in which creditors are paid from the proceeds of the liquidation estate. The hierarchy is as follows:

Insolvency Resolution Process Costs and Liquidation Costs (First Charge): These include the fees and expenses incurred by the insolvency professional and liquidator, which are paid before any creditor receives a share. Secured Creditors and Workmen's Dues (Second Priority, Pari Passu) Secured creditors who relinquish their security interest share proceeds equally with workmen's dues for the past 24 months. If secured creditors have enforced their security interest separately, they will not be paid again under this category.

Unsecured Financial Creditors (Third Priority): Includes banks and financial institutions that provided loans without collateral.

Operational Creditors (Fourth Priority): Includes suppliers, vendors, and service providers owed dues by the company.

[21] Relinquishment of Security by a Secured Creditor. (2019). Vinod Kothari & Company. Retrieved from https://vinodkothari.com/wp-content/uploads/2019/01/Relinquishment-of-Security-by-a-Secured-Creditor.pdf Visited on 5 December, 2024

Government Dues and Remaining Secured Creditors (Fifth Priority): Government dues (taxes, penalties, etc.) receive payment only after financial and operational creditors are settled. Any remaining secured creditors (who did not enforce security or received partial recovery) fall into this category.

Equity Shareholders and Residual Stakeholders (Last Priority): Equity shareholders receive payment only after all creditors are satisfied, which rarely happens in insolvency cases.

Impact of the Waterfall Mechanism on Secured Creditors: Secured creditors receive priority over most other creditors if they relinquish their security. If they enforce security separately, they bear the risk of asset undervaluation. Unsecured creditors, including suppliers and government authorities, receive lower priority, increasing the importance of being a secured creditor. The waterfall mechanism provides a structured and predictable system that benefits secured creditors while ensuring fair treatment of all stakeholders.[22]

Challenges in Enforcing Secured Creditors' Rights

Despite the clear legal framework, secured creditors face practical challenges:

- Conflicts Between IBC and SARFAESI Act: While IBC provides a structured process, the SARFAESI Act, 2002, allows banks to enforce security separately, sometimes creating legal conflicts.
- Delays in Liquidation and Asset Disposal: Liquidation often takes longer than expected, leading to value erosion of secured assets.
- Judicial Overreach and Litigation Risks: Frequent litigation by operational creditors or government authorities can delay the liquidation process and impact secured creditors' recoveries.
- Challenges in Valuation of Secured Assets: Assets pledged as security may not yield expected value, especially in cases of specialized or depreciating assets.
- Lack of Clarity in Section 52 Enforcement Procedures: While Section 52 grants secured creditors autonomy, practical enforcement mechanisms need further clarity to avoid disputes.[23]

[22] Winding-up priority to secured creditors. (2024, December 9). *IBCLaw.in*. Retrieved from https://ibclaw.in/ca-subject/winding-up-priority-to-secured-creditors/ Visited on 5 December 2024

[23] Katti, A. and Venkatesh, N., 2022. A Critical and Comparative Analysis of the'Waterfall Mechanism'Provided under the Insolvency and Bankruptcy Code of 2016. *Issue 6 Indian JL & Legal Rsch.*, *4*, p.1.

Impact of Winding-Up on Secured Creditors and Practical Challenges in Recovery

The winding-up process of a company significantly impacts secured creditors, determining how and when they can recover their dues. While the Insolvency and Bankruptcy Code (IBC), 2016, provides a structured mechanism for handling corporate insolvency, practical challenges often hinder the effective realization of secured creditors' rights. This section explores the effects of winding-up on secured creditors, the procedural hurdles they face, and possible reforms to strengthen creditor protection.[24]

Legal Framework Governing Secured Creditors in Winding-Up

Secured creditors are those whose loans or credit facilities are backed by collateral, such as property, machinery, inventory, or receivables. Under the IBC, 2016, their rights are governed primarily by:

- **Section 52:** Grants secured creditors the right to either enforce their security outside liquidation or relinquish it to the liquidation estate.
- **Section 53:** Establishes the **waterfall mechanism**, prioritizing secured creditors over other stakeholders in distribution of liquidation proceeds.
- **Section 238:** Provides IBC with overriding effect over conflicting laws like the **Companies Act, 2013**, and the **SARFAESI Act, 2002**, unless specified otherwise.

Despite this legal clarity, secured creditors encounter several practical obstacles when seeking to recover their dues during a company's winding-up.

Effects of Winding-Up on Secured Creditors

When a company enters **winding-up (liquidation),** secured creditors face several key consequences:

1. Freezing of Assets and Operations: Once liquidation begins the company's assets are locked until the liquidator determines their status. Secured creditors cannot initiate new legal proceedings to enforce their claims unless they opt to recover security outside liquidation. Assets pledged as collateral become part of the liquidation estate unless the creditor chooses to enforce security independently under Section 52.

---

[24] Impact of IBC on winding-up. (n.d.). *Impact-IBC.pdf*. Retrieved from https://icmai.in/upload/Students/Supplementary/Impact-IBC.pdf Visited on 5 December 2024

2 Impact on Recovery Rates: The amount recovered by secured creditors depends on:

Asset valuation: If collateral assets depreciate in value, secured creditors recover less than expected. Market conditions: The sale of assets may take time, reducing liquidation proceeds. Interim costs: Liquidation expenses (e.g., legal fees, administrator fees) reduce the final payout to secured creditors.

3 Prolonged Recovery Periods: Secured creditors may experience delays due to: Pending litigation from other creditors, employees, or tax authorities; Challenges in asset disposal, especially if assets are unique or niche; Overburdened insolvency courts leading to procedural delays. These delays affect the financial stability of banks, NBFCs, and institutional lenders, increasing the risk of bad loans.

Practical Challenges Faced by Secured Creditors in Recovery

1 Conflict Between IBC and Other Recovery Laws

Secured creditors often face conflicts between IBC and pre-existing laws like: SARFAESI Act, 2002: Allows banks to seize and auction collateral assets, sometimes creating jurisdictional clashes. Companies Act, 2013: Contains winding-up provisions that differ from IBC, leading to confusion in cases involving older companies. Income Tax Act, 1961: Government dues have historically taken precedence over creditors, leading to competing claims. Although Section 238 of IBC gives it overriding authority, creditors frequently engage in legal battles over priority issues.[25]

2 Challenges in Asset Liquidation and Valuation

Secured creditors recover their dues by selling collateral. However:

- Distressed assets often fail to attract buyers, forcing creditors to accept lower prices.
- Land and real estate assets are illiquid, requiring longer periods for sale.
- Machinery and inventory lose value quickly, reducing potential recovery amounts.

In some cases, the liquidator's valuation differs from the creditor's expectations, leading to disputes over asset pricing.

3 Delays in Liquidation Process

[25] Step-by-step guide to winding up of the company under IBC 2016. (2025, October 2). *Incorpadvisory*. Retrieved from https://incorpadvisory.in/blog/step-by-step-guide-to-winding-up-of-the-company-under-ibc-2016/

Although IBC aims for time-bound resolution (330 days including extensions), in practice:

- Litigation from operational creditors and regulatory authorities prolongs the process.
- Multiple appeals in NCLT and NCLAT delay asset distribution.
- Inefficiencies in liquidator appointment and execution slow down proceedings.

As a result, secured creditors sometimes recover their dues years after liquidation begins, diminishing the value of their claims due to inflation and opportunity costs.

4 Risk of Lower Recovery for Secured Creditors Who Relinquish Security

If a secured creditor chooses to relinquish their security and become part of the liquidation pool under Section 53, they:

- Must wait for liquidation proceeds, unlike creditors who enforce security independently.
- Share funds pari passu (equally) with workmen's dues, potentially lowering their final payout.
- Lose the ability to influence how their collateral is disposed of.

For this reason, banks and financial institutions often prefer to enforce security under SARFAESI or the Debt Recovery Tribunal (DRT) instead of relying solely on the IBC process.[26]

Conclusion

The status of secured creditors in the process of winding up is a critical aspect of insolvency law, influencing the stability of financial institutions, investor confidence, and overall economic health. While the Insolvency and Bankruptcy Code (IBC), 2016, has significantly improved the treatment of secured creditors in India, various challenges persist, such as delays in resolution, conflicts with other laws, valuation disputes, and enforcement hurdles. This section summarizes key findings and suggests reforms to strengthen secured creditors' rights and improve the efficiency of India's insolvency framework.

Suggestions

1. Harmonise Legal Provisions: Align the IBC and Companies Act to remove overlaps and clarify the order of payments to secured creditors. This will ensure consistency and reduce litigation.

[26] Alur, N.A., 2022. Comparative Analysis of Winding up of a Company: Perspectives in UK, USA & India. *Issue 2 Indian JL & Legal Rsch.*, *4*, p.1.

2. Clear Valuation and Enforcement: Introduce transparent valuation standards and strict timelines for realising secured assets to prevent undue delays.
3. Equitable Treatment: Balance the rights of secured and unsecured creditors to ensure fairness in liquidation proceeds.
4. Empower Liquidators: Strengthen liquidator’s authority to verify and manage secured assets through access to centralised asset records.
5. Uniform Distribution Guidelines: IBBI should issue clear norms for distributing sale proceeds where multiple secured creditors are involved.
6. Digital Transparency: Implement e-auction platforms and digital asset monitoring to enhance transparency and efficiency in liquidation.
7. Pre-Liquidation Resolution: Require secured creditors to participate in resolution efforts before enforcing security rights.
8. Cross-Border Clarity: Define rules for foreign secured creditors under cross-border insolvency to promote investor confidence.
9. Professional Training: Conduct regular training for insolvency professionals and liquidators on valuation, distribution, and asset realisation.
10. Data-Driven Reforms: Encourage empirical studies on recovery rates and judicial outcomes to support evidence-based policy improvements.

Reference

1. Alur, N.A., 2022. Comparative Analysis of Winding up of a Company: Perspectives in UK, USA & India. *Issue 2 Indian JL & Legal Rsch.*, *4*, p.1.
2. Brinkmann, M., 2008. The position of secured creditors in insolvency. *European Company and Financial Law Review*, *5*.
3. Jackson, T.H. and Kronman, A.T., 1978. Secured financing and priorities among creditors. *Yale LJ*, *88*, p.1143.
4. Katti, A. and Venkatesh, N., 2022. A Critical and Comparative Analysis of the'Waterfall Mechanism'Provided under the Insolvency and Bankruptcy Code of 2016. *Issue 6 Indian JL & Legal Rsch.*, *4*, p.1.
5. Mann, R.J., 2022. Explaining the pattern of secured credit. In *The Creation and Interpretation of Commercial Law* (pp. 347-405). Routledge.

6. Mohan, M.P., 2023. Environmental Claims under Indian Insolvency Law: Concepts and Challenges. *Tex. Int'l LJ*, *59*, p.105.
7. Samy, A.K., 2022. Analysis of Swiss Ribbons (P) Ltd. and Ors. vs Union of India (2019) SCC Online SC 73. *Part 2 Indian J. Integrated Rsch. L.*, *2*, p.1; Khandelwal, H., 2019. Determining the Constitutionality of IBC-Swiss Ribbons Pvt. Ltd. v/s Union of India, 2019. *Ltd. v/s Union of India*.
8. Singh, S., 2021. Liquidation Waterfall Mechanism under Insolvency & Bankruptcy Code, 2016. *Indian JL & Legal Rsch.*, *2*, p.1.
9. Wood, R.J., 2010. The Definition of Secured Creditor in Insolvency Law. *Banking & Finance Law Review*, *25*, p.341.
10. Step-by-step guide to winding up of the company under IBC 2016. (2025, October 2). *Incorpadvisory*. Retrieved from https://incorpadvisory.in/blog/step-by-step-guide-to-winding-up-of-the-company-under-ibc-2016/
11. Relinquishment of Security by a Secured Creditor. (2019). Vinod Kothari & Company. Retrieved from https://vinodkothari.com/wp-content/uploads/2019/01/Relinquishment-of-Security-by-a-Secured-Creditor.pdf
12. Changes in winding-up procedure in IBC 2016. (2022, December 26). *Taxmann*. Retrieved from https://www.taxmann.com/post/blog/changes-in-winding-up-procedure-in-ibc-code-2016
13. Impact of IBC on winding-up. (n.d.). *Impact-IBC.pdf*. Retrieved from https://icmai.in/upload/Students/Supplementary/Impact-IBC.pdf
14. Rights of Secured Creditors under the Insolvency and Bankruptcy Code, 2016. (2020, June 30). *IBCLaw.in*. Retrieved from https://ibclaw.in/rights-of-secured-creditors-under-the-insolvency-and-bankruptcy-code-2016-by-advocate-sabhay-choudhary/
15. Winding-up priority to secured creditors. (2024, December 9). *IBCLaw.in*. Retrieved from https://ibclaw.in/ca-subject/winding-up-priority-to-secured-creditors/
16. IBC-2016. (n.d.). *IBBI*. Retrieved from https://icmai.in/upload/Students/Supplementary/IBC-2016.pdf
17. Legal framework for winding-up by tribunal. (n.d.). *IBBI*. Retrieved from https://ibbi.gov.in/uploads/legalframwork/547c9c2af074c90ac5919fa8a5c60bd4.pdf
18. Understanding the IBC: Winding-up and Liquidation. (2021). *IBBI*. Retrieved from https://ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf