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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal provide dedicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

WHITE BLACK LEGAL: THE LAW JOURNAL

The viability of applications for the initiation of a corporate insolvency resolution procedure depends primarily on the applicant first convincing the Tribunal that it falls within either the IBC's definition of 'financial creditor' or 'operational creditor.'

This article traces legislative and judicial developments pursuant to the definition and distinction between financial creditor and Operational creditor. It provides a birds' eye view of the settled legal position on these terms and analyses the rationale behind that view.

It is hoped that it would help all stakeholders gain a greater understanding of the Code and the jurisprudence under which practice has been enriched.

INTRODUCTION:

The Code was promulgated in 2016 following a series of recommendations to revamp the insolvency system for India. It was hoped it would include a centralized insolvency structure that would give investors, creditors and other market participants' clarity about procedure, time and outcome.

The *Insolvency and Bankruptcy Code, 2016*¹ (Code) re-conceptualized India's insolvency resolution system. It offers a framework for debtors' insolvency resolution in a time-limited manner to optimize the value of their properties, with a view to fostering entrepreneurship, credit access, and balancing all stakeholders' interests.

It provides for a market mechanism to rescue firms in financial distress and facilitate the closure of firms in economic distress, in accordance with the Code processes and the rules and regulations that are made thereunder.

The National Company Law Tribunals, the National Company Law Appellate Tribunal, the High Courts and the Supreme Court ruled with unprecedented speed on matters covered by the Code, and given clarity on the interpretation of key concepts under it. Such innovations have strengthened the country's insolvency jurisprudence and practice.

The Code implemented a creditor-in-control system for corporate entities (with a focus on empowering financial creditors), a time-bound resolution mechanism and reduced scope for judicial interference, and developed institutions such as India's Insolvency and Bankruptcy Board, insolvency practitioners, and information services.

¹ The Insolvency and Bankruptcy Code, 2016 (No. 31 of 2016)

The Code has updated and revised the laws relating to corporate reorganization and insolvency, partnership businesses, and individual firms. The main aim of this law is to encourage a time-bound resolution of the corporate bankruptcy. In contrast to the Companies Act, 2013, the IBC has introduced new and distinct concepts of 'Financial Creditor' and 'Operational Creditor' which merely introduced the term 'creditor' without any classification of it.

The sustainability of applications for the initiation of a corporate insolvency resolution process depends primarily on the applicant first satisfying the Tribunal that it falls within either the IBC's definition of 'financial creditor' or 'operational creditor'.

CONSTITUTIONAL VALIDITY OF THE PROVISIONS TREATING FINANCIAL CREDITORS AND OPERATIONAL CREDITORS DISTINCTIVELY:

The constitutional validity of different provisions of the Code has been challenged before the Hon'ble Supreme Court. In its judgment in *Swiss Ribbons Pvt. Ltd. Vs Union of India*², the Hon'ble Court held that the judiciary should exercise restraint while examining the constitutional validity of economic legislation since "in complex economic matters each decision is necessarily empirical is based on experimentation or what might be termed the trial and error method and therefore, its validity cannot be tested on any rigid prior considerations or on the application of any straitjacket formula."³ In that sense, the Court affirmed the constitutional validity of all the provisions challenged before it.

A large number of challenges before the Court were against the provisions which dealt separately with financial creditors and operational creditors.

Firstly, the Court noted the distinction between financial debt and operational debt in the following words "a financial debt is a debt along with interest, if any, which is disbursed against the time value of money consideration. It may also be money borrowed or raised in any of the ways prescribed in *Section 5(8)*⁴ of the Code or in any other way, as Section 5(8) of the Code is an inclusive definition. On the other hand, an 'operational debt' may include a claim for provision of goods or services, including employment, or a debt for payment of dues arising

² *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India*, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019

³ *Ibid* Page 2

⁴ Section 5(8) of the Insolvency and Bankruptcy Code 2016

under any statute and payable to the Government or any local authority.”⁵ It further relied on the Final Report of the Bankruptcy Law Reform Committee, the Notes on Clause 8 of the Insolvency and Bankruptcy Bill, 2015 and the Report of the Insolvency Law Committee, to broadly lay down the distinctions between financial and operational creditors as “most financial creditors, particularly banks and financial institutions, are secured creditors whereas most operational creditors are unsecured, payments for goods and services as well as payments to workers not being secured by mortgaged documents and the like.”⁶ The Court also distinguished between the nature of agreements entered into with financial creditors and operational creditors, where the former generally lends for working capital or on a term loan and involves a larger quantum of money as compared to the latter where the agreement mostly relates to the supply of goods and services. Therefore, the Court held that the distinction between the two is based on intelligible differentia with a rational nexus to the objectives that the Code seeks to achieve.

The Court also distinguished between the existence of agreements concluded with financial creditors and operational creditors, where the former generally lends for working capital or a term loan and includes a larger amount of money compared to the latter, where the contract mainly relates to the provision of goods and services. Consequently, the Court held that the distinction between the two was based on intelligible differentia with a rational nexus to the goals the Code seeks to achieve.

Secondly, the Court stressed that the most significant difference between financial and operational creditors is that “Financial creditors are involved in assessing the viability of the corporate debtor from the very beginning. They can, and thus do, engage in loan restructuring as well as reorganizing the business of the corporate debtor when there is financial stress, which are things operational creditors do not and cannot do.”⁷ This was relied on, along with the statutory and case law developments that guarantee fair and equitable treatment to operational creditors, to hold that the provisions granting only financial creditors the right to vote as part of the committee of creditors are legitimate.

Thirdly, the Court also analyzed whether the difference between the operational creditors and financial creditors in the process of triggering the corporate insolvency resolution process was

⁵ Ibid Page 2

⁶ Ibid Page 2

⁷ Ibid Page 2

arbitrary. The Court held that since financial creditors must prove that there is “default” on the basis of solid documentation, or information in an easily verifiable information utility, it was justifiable that they were not required to provide a notice of demand to the corporate debtor. This is contrary to the requirement imposed on an operational creditor to give a notice of demand to the corporate debtor, who “claims only the right to pay a liability or obligation for a debt that may be due”.⁸

THE CONCEPT OF “OPERATIONAL DEBT” AND “FINANCIAL DEBT” UNDER THE CORPORATE INSOLVENCY RESOLUTION

PROCESS:

A company has various types of creditors each having different rights and motivations. Accordingly, their issues are different when insolvency resolution begins, and will need to be compensated for differently.

In India, three different types of creditors are recognized in the Code: financial creditors, operational creditors and other creditors. Each of these was given different rights and competences. Accordingly, the determination of which types of debt would be classified as financial, operational or other debt becomes relevant.

FINANCIAL DEBT:

The term "financial debt" is specified in section 5(8) of the Code "to mean a debt, together with interest, if any, that is disbursed against the consideration for the time value of money." An illustrative list of transactions that would fall under this description has also been included. Typically, financial creditors are those "who have a pure financial contract relationship with the corporation, such as a loan or debt guarantee. Operational creditors are those whose responsibility comes from an operating transaction from the corporation."⁹ However, under the Code, homebuyers were also deemed to be financial creditors following the recommendations of the Insolvency Law Committee.¹⁰ If a creditor is a financial creditor, he has the ability to initiate the process of insolvency resolution, the ability to make claims in this process, and the right to be a voting member of the creditors' committee which accepts or rejects a resolution plan.

⁸ Ibid Page 2

⁹ Bankruptcy Law Reform Committee, Report of the Bankruptcy Law Reform Committee, Para 5.2.1 Vol. I (2015)

¹⁰ Section 5(8)(f) of The Insolvency and Bankruptcy Code, 2016

Section 5(20) of the Code describes an operational debt as “a claim relating to the procurement of goods or services including employment or debt relating to the payment of dues arising under any law for the time being and payable to the central government, any government of the State or any local authority.” Operational creditors are those whose claims arise “as a result of a transaction on operations. Thus, an operational creditor is the wholesale vendor of spare parts whose spark plugs are kept in inventory by car mechanics and payable only after the spark plugs are sold. Similarly, the lessor from whom the company leases property is an operational creditor to whom the company owes monthly rent on a three-year contract.”¹¹ An operational creditor is entitled to apply for the initiation of a corporate debtor's insolvency resolution procedure, to file a claim in the insolvency resolution process, and to participate in a creditors' committee without voting rights.

In *Swiss Ribbons Ltd. v. Union of India*¹², the Court defined the distinction between ‘Financial Debt’ and ‘Operational Debt’ in the following terms: “A perusal of the concept of ‘financial creditor’ and ‘financial debt’ makes it clear that a financial debt is a debt along with interest, if any, that is disbursed against the time value of money consideration. It may also be money borrowed or raised in any of the ways prescribed in section 5(8) of the Code or otherwise, as section 5(8) is an inclusive definition. In contrast, an “operational debt” would include a charge in conformance with the provision of goods or services, including employment, or debt for the payment of dues existing under any law payable to the Government or any local authority.” The Court also commented on the difference between the nature of the Financial Creditor Agreement and the nature of the Operational Creditor Agreement by noting that “financial creditors typically provide financing on a term loan or for working capital that enables the corporate debtor to either develop and/or operate its business. On the other hand, arrangements with operating creditors are related to the provision of goods and services in the company operations. In general, the financial contracts require large amounts of money. Operational contracts, by contrast, have dues whose quantity is generally smaller.”

There has been a lack of clarity about what constitutes "time value of money" while determining what constitutes financial debt. This was interpreted most notably in *Nikhil Mehta Vs AMR Infrastructure*¹³. The main issue in this case was whether investors in real estate could be considered financial creditors, in favor of whom guaranteed returns were stipulated

¹¹ Ibid Page 4

¹² Ibid Page 2

¹³ Nikhil Mehta & Sons (HUF) & Ors VS AMR Infrastructure Ltd., C.P. No. (ISB)-O3 (PB)/2017; Decision date- 23.01.2017

(as per their contracts). In arguing that these investors should not be considered financial creditors, the Hon'ble NCLT argued in this case that "the first basic condition of financial debt must be fulfilled, which is, that the debt is disbursed against the consideration of the time value of money and that it may include the events specified in different sub-clauses...The key feature of financial transactions as set out in section 5(8) of the Code is their consideration of the time value of money. In other terms, the legislature has included these financial transactions in the concept of 'financial debt' which is typically for a sum of money earned today to be paid in a single or sequence of future payments over a period of time. It might also be a sum of money invested today to be repaid in a single or a series of instalments to be paid in the future over a period of time. The term "Time Value" has been defined in *Black's Law- Dictionary*¹⁴ as meaning "the price associated with the length of time an investor has to wait until an investment matures or the associated income is earned." The inflows and outflows are distanced by time in both cases, and there is compensation for time value of money..."

The concept of time value of money has been examined in other cases as well. Most notably, the Hon'ble NCLT clarified in *Uttam Galva*¹⁵ that "business always runs with the time value for money in mind ...the transaction shall be operational if the payment is for goods or services, the transaction shall be financial if the money is lent in the form of interest in consideration of returns." So, just because an operational creditor claims interest on a delayed payment doesn't mean the claim becomes a financial debt claim.

The parties' intent, i.e. advancing money for financial returns or providing goods and services, can be examined in determining whether or not a debt is financial. Lending for the time value of money, however, does not mean that the debt must bear interest. In *Shailesh Sangani v. Joel Cardoso*¹⁶, while analyzing the definition of "financial debt", the Hon'ble NCLAT held that interest is not a sine qua non for a debt to be classified as 'financial debt' as defined under section 5(8) of the Code. What is important is that the amount was disbursed, with or without bearing interest, against the time value of money. The Hon'ble Appellate Tribunal further noted that "Section 5(8) clauses (a) to (i) of the Code embody the nature of transactions included in the definition of "financial debt." It includes money borrowed against interest payments. Section 5(8) (f) of the Code specifically deals with the amount raised in respect of any other

¹⁴ Black's Law- Dictionary (9th edition)

¹⁵ DF Deutsche Forfait AG and Ors Vs Uttam Galva Steel Ltd.,
C.P. No. 45/I&BP/NCLT/MAH/2017; Decision date- 10.04.2017

¹⁶ Shailesh Sangani Vs Jolel Cardoso, Company Appeal (AT) (Insolvency) No.616 of 2018; Decision date- 30.01.2019

transaction having the commercial effect of a borrowing which also includes a forward sale or purchase agreement. It is obvious that money advanced by a Corporate Debtor's Promoter, Director or Shareholder as a stakeholder to strengthen the Company's financial health and raise its economic prospects will have the commercial impact of borrowing on the part of Corporate Debtor, given the fact that no interest provision is made on it.”

OPERATIONAL DEBT:

There has been a lack of clarification in deciding what constitutes “Operational debt” on what basis the meaning of the definition should be and whether it should cover all debts other than financial debts. The Hon’ble NCLT interpreted the definition of “Operational creditor” under the Code in *Col. Vinod Awasthy v. AMR Infrastructure Limited*¹⁷. The Hon’ble NCLT observed that the Code framers had not proposed to include a debt other than a financial debt within the expression of an “Operational debt.”

An operational debt would therefore only be related to four categories, as set out in section 5(21) of the Code, such as goods, services, employment and government dues. In the cases of *Mukesh Kumar v. AMR Infrastructure Limited*¹⁸ & *Pawan Dubey and Another v. J.B.K. Developers Private Limited*¹⁹, a similarly strict approach to understand this section was depicted.

However, the concept has been more widely described on a case-by - case basis. In *Renish Petrochem FZE v. Ardor Global Private Limited*²⁰, for example, the NCLT held that "the amount due from the purchaser of the goods and due to the seller of the goods and guaranteed by the Guarantee Agreement is also a 'operational debt.'

OTHER DEBTS:

Certain debts are those debts that are neither operational, nor financial. Although there were no clear provisions in the Code granting these creditors the right to initiate or monitor the insolvency resolution process, India's Insolvency and Bankruptcy Board, by amending India's

¹⁷ Col. Vinod Awasthy Vs AMR Infrastructure Limited, C.P. No. (IB)10(PB)/2017; Decision date- 20.02.2017

¹⁸ Mukesh Kumar Vs AMR Infrastructure Limited, C.P. No. (IB)-30(PB)/2017; Decision date- 31.03.2017

¹⁹ Pawan Dubey and Another Vs J.B.K. Developers Private Limited, C.P. No. (IB)- 19(PB)/2017; Decision date- 16.02.2018

²⁰ Renish Petrochem FZE Vs Ardor Global Private Limited, C.P. (I.B) No. 33/9/NCLT/AHM/2017; Decision date- 31.07.2017

Insolvency and Bankruptcy Board (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, allowed "Other creditors" to file claims in the process.

WHO IS A FINANCIAL CREDITOR?

A financial creditor is defined under Section 5(7) of the Code to mean "a person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred".

To determine whether a person is a financial creditor, the debt owed to such a person must fall within the scope of the "Financial Debt" as described in Section 5(8) of the Code.

As specified in Section 5(8) of the Code, a financial debt shall mean:

"A debt with interest, if any, disbursed against the time value of money consideration and included-

- Funds borrowed against payments of interest;
- Any amount raised by acceptance under any credit facilities or their de-materialized equivalents;
- Any amount received pursuant to a note-buying facility or issuance of bonds, shares, debentures, loan stocks or related instruments;
- The amount of any liability in respect of any lease or hire purchase contract that is deemed to be Indian Accounting Standards finance or capital lease or other accounting standards as may be prescribed;
- Receivable sold or discounted, rather than any non-recourse receivable issued;
- Any amount paid under some other contract, including any forward sales or purchase deal, having the commercial effect of borrowing;
- Any obligation to compensate a bank or financial institution in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued;
- The sum of any liability for any guarantee or indemnity in respect of any of the things referred to in sub-clauses (a) to (h) of this clause.'

WHO IS AN OPERATIONAL CREDITOR?

Under Section 5(20) of the Code an “Operational creditor” is defined as “Any person to whom the operating debt is owed and includes any person to whom the debt was legally assigned or transferred”.

To determine if any individual should fall within the definition of an operational creditor, the debt owed to that individual must fall within the meaning of an operational debt as specified in Section 5(21) of the Code.

Under section 5(21) of the Code an Operational debt is defined as: “A representation in respect of provisions of goods or services like employment or debt relating to the repayment of dues existing under any statute and payable to the Central Government, any State Government or any local authority for the time being.”

DISTINCTION BETWEEN A FINANCIAL CREDITOR AND OPERATIONAL CREDITOR:

Distinction between a Financial creditor and Operational creditor has been drawn by *the Bankruptcy Law Reforms Committee in Para 5.2.1 of its final report*²¹.

It states: “Here, the Code distinguishes between financial creditors and operational creditors. Financial creditors are those whose arrangement with the corporation is a pure financial contract, such as a loan or debt security. Operational creditors are those whose obligations emerge from an operational transaction ... The Code also allows for situations where a creditor has both a solely financial transaction as well as an operational transaction with the corporation. In such a scenario, the creditor may be considered as a financial creditor to the extent of the financial debt and as an operational creditor to the extent of the operational debt.”

It is obvious that the lawmakers have chalked out distinct definitions of “financial creditor” and “operational creditor” and are not to be interpreted as inclusive or exclusive of each other.

TREATMENT OF HOME BUYERS IN THE CORPORATE INSOLVENCY RESOLUTION PROCESS:

The Code defines the terms 'financial debt' and 'operational debt' under Section 5 of the Code. These cover various types of claims against the corporate debtor, however, classes of other

²¹ Available at http://finmin.nic.in/reports/BLRCReport_Vol1_04112015.pdf

claimants may exist that are neither financial nor operational creditors. Initially, when claims were brought forward in respect of pre-payments made by home buyers, the Hon'ble NCLT held that homebuyers were neither financial creditors nor operational creditors.²² However, in cases where assured returns were guaranteed to home buyers, financial creditors were held to be such.²³

Given that home buyers were not considered either financial creditors or operational creditors in most cases, they could not initiate the process of corporate insolvency resolution or participate in the creditors' committee.

In addition, India's Insolvency and Bankruptcy Board (Insolvency Resolution Process for Private Persons) Rules, 2016 initially offered only a framework for the filing of claims by operational and financial creditors. As such homebuyers confronted procedural difficulties in claim filing. Once concerns about homebuyers' inclusion had been brought to the fore, India's Insolvency and Bankruptcy Board amended the Regulations to allow "other creditors" to file their claims with the insolvency resolution process as well.²⁴ However, they were not permitted to initiate an insolvency resolution process or to vote as members of the creditors' committee. As such, wider issues with respect to safeguarding home buyers' rights remained unaddressed.

In *Chitra Sharma Vs Union of India*, the Hon'ble Supreme Court suggested that the interests of homebuyers be safeguarded by professional insolvency resolution and passed orders allowing representatives championing homebuyer' cause to participate in creditors' committee meetings²⁵. Similarly, the Supreme Court passed orders in *Bikram Chatterji Vs Union of India*²⁶ concerning the construction of homes and also required the furnishing of undertakings to protect the interests of homebuyers.

Against this background, the Insolvency Law Committee stated that "Reviewing the different financial terms of home buyers' and builders' agreements and the way in which home buyers' disbursements to builders are used, it is evident that the agreement is to disburse the home

²² Ibid Page 6

²³ Ibid Page 5; Anil Mahindroo & Anr Vs Earth Organics Infrastructure, NCLAT New Delhi, Company Appeal (AT) (Insolvency) No. 74/2017; Decision date- 02.08.2017

²⁴ Regulation 9A, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons), 2016

²⁵ Chitra Sharma v. Union of India, Writ Petition(s) (Civil) No(s).744/2017; Decision date- 09.08.2018

²⁶ Bikram Chatterji v. Union of India, Writ Petition(s)(Civil) No(s).940/2017; Order date- 21.02. 2018

buyer's money for the future delivery of a building to be built. The disbursement of money is made in relation to a future asset, and the contracts usually span a period of 4-5 years or more ... the amounts thus raised are used as a means of financing the real estate project, and are thus in effect a tool for raising finance, and when the project fails, money is reimbursed on the basis of time value of money.”²⁷ Accordingly, they recommended that home buyers be included as financial creditors.

On the basis of these recommendations, the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018²⁸ amended the definition of “financial debt” to reflect that an amount raised from a “allottee” under an real estate project would be deemed to be an amount having the commercial effect of borrowing, bringing homebuyers squarely within the statutory scope of the term “financial creditor” under the Code.²⁹ Homebuyers thus now are voting members in the creditors’ committee.

Following this, the Hon'ble NCLAT observed, “Normally, a Real Estate “allottee” is within the meaning of “Financial Creditor”, but if such an “allottee” does not pay the full amount, the “Corporate Debtor” cannot claim default. If the “Corporate Debtor” fails to complete the work in a timely manner and the “allottee” is agreed to pay the total amount or has paid the total amount, only then “allottee” may claim default. Similarly, if “allottee” finds that the “Corporate Debtor” has not completed in time and if it requests that the amount disbursed to the “Corporate Debtor”, be returned, the allottee may claim the default on the part of the “Corporate Debtor” for failure to refund the amount.”³⁰

It is important to note, however, that simply being a homebuyer would not automatically bring the homebuyer within the scope of the term “financial creditor”. There has to be an actual debt owed to such homebuyer, payable for the purposes of the Code by the infrastructure/ builder firm. With respect to *Ajay Walia Vs M/s. Sunworld Residency Private Limited*,³¹ the homebuyer had entered into an apartment purchase agreement with the builder, as well as a

²⁷ Insolvency Law Committee, Report of the Insolvency Law Committee, available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf

²⁸ The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 (No. 26 of 2018)

²⁹ Insolvency and Bankruptcy Code (Second Amendment Act), 2018 available at [http://ibbi.gov.in/webadmin/pdf/legalframework/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20\(Second%20Amendment\)%20Act,%202018_2018-08-18%2018:40:34.pdf](http://ibbi.gov.in/webadmin/pdf/legalframework/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20(Second%20Amendment)%20Act,%202018_2018-08-18%2018:40:34.pdf)

³⁰ Anil Kumar Tulsiani v. Rakesh Kumar Gupta, Company Appeal (AT) (Insolvency) No. 35 of 2019; Decision date- 22.01.2019

³¹ *Ajay Walia v. M/s Sunworld Residency Private Limited*, CP (IB) 11/ALD/2018; Decision date- 30.07.2018

supplementary agreement that gave the homebuyer the option of cancelling the purchase of the apartment within twenty-four months from the date the bank disbursed the home loan. The homebuyer, the bank and the builder also entered into a tripartite agreement by virtue of which the builder was to pay the EMIs to the bank for the first twenty-three months from the date on which such loans were disbursed. Such payment was however not to be construed as reducing the homebuyer's liability in any way. The Tripartite Agreement further provided that in the event of a default under the Agreement resulting in the cancellation of the allocation and/or for any cause whatsoever if the reservation is cancelled, any sum payable to the borrower in that event, be paid to the bank and it will be construed as a legitimate discharge of the Builder's liabilities towards the homebuyer. When the homebuyer cancelled the reservation, and later the builder defaulted on EMIs payment, the homebuyer approached the Hon'ble NCLT to start the corporate insolvency resolution proceedings against the builder. The Hon'ble NCLT observed here that since the homebuyer subrogated all of its rights to the bank, it could not be regarded as a financial creditor.

Given that home buyers were not given the right to initiate the insolvency resolution process or to vote as members of the creditors' committee, there was fear that their interests would not be sufficiently safeguarded. Accordingly, the courts placed ad hoc protections in different rulings. In order to address this problem, home buyers have now been considered by amendment to the Code as financial creditors, and are members of the creditors' committee.³²

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CONCLUSION:

Financial and operational creditors vary in the sense that their obligations come from different backgrounds. Where financial creditor is liable for contracts such as a loan or debt, and operational creditor is liable for operational transactions.

It is sine qua non to show that the borrower falls within the scope and context of the definition of either "financial creditor" under section 5(7) or "operational creditor" under section 5(20) of the Code in order to be effective in initiating corporate insolvency resolution proceedings against a debtor. It is clear from the case laws mentioned above that the tribunals are rigorous in the definition of "operational creditor" under the Code and refrain from entertaining

³² Available at https://ibbi.gov.in/webadmin/pdf/whatsnew/2019/Jun/190609_UnderstandingtheIBC_Final_2019-06-09%2018:20:22.pdf

applications where applicants are not strictly within the scope of the Code and have alternative effective remedies available.³³

The primary criterion for deciding if a debt is a financial debt is whether it has been extended for monetary time value. On the other hand, if it applies to any of the four categories: goods, services, and employment and government dues, debt will be operational debt. Debts other than these debts will be listed as other debts. The rights and powers of the respective creditors of each of these different debt categories are different, and thus debt classification is important in the process of corporate insolvency resolution.

From an insight into the foregoing article, and according to the Bankruptcy Law Reforms Committee in paragraph 5.2.1 of its final report, the difference between a financial creditor and an operational creditor is that a financial creditor is an individual whose relationship with the company is based solely on financial contracts, such as a loan or debt guarantee. Whereas an operational creditor is an individual whose liabilities originate from the company in the form of potential payments in exchange for goods or services already provided.



This article is intended to be used for educational purposes only and must not be construed to be a guide for taking or recommending any action or decision, commercial or otherwise.

This is a broad summation of principles and case laws relating to the financial creditors and operational creditors under the Insolvency and Bankruptcy Code, 2016 and their distinction. The application of these is subject to the facts and circumstances of every case.

Please seek professional advice before taking any action or decision using the material presented here.

³³Available at

<https://www.mondaq.com/india/insolvencybankruptcy/607738/financial-creditor-and-operational-creditor-under-the-insolvency-and-bankruptcy-code-2016>