

## Fundamentals of IBC: Financial Creditor v. Operational Creditor

### Introduction

Insolvency and Bankruptcy Code, 2016 ('Code') recognizes two kinds of debts that are usually referred to during the process of corporate insolvency resolution:

- a. the 'financial debt' which is defined under Section 5(8) of the Code
- b. the 'operational debt' which is defined under Section 5(21) of the Code

On the basis of the said distinction, the Code identified two kinds of creditors i.e. 'financial creditor' (to whom a financial debt is owned by the Corporate Debtor) and 'operational creditor' (to whom a financial debt is owned by the Corporate Debtor). However, the Code creates various distinctions in the treatment granted to them in terms of (i) right to apply to NCLT (scope of adjudication), (ii) rights as a member of the Committee of Creditors ('CoC') (iii) right to receive amounts under Resolution Plan and upon liquidation of the Corporate Debtor, inter alia.

### 1. Right to Apply before the Adjudicating Authority

Financial Creditor	Operational Creditor
Application under S. 7 read with Regulation 4 (Form 1)	Application under S. 9 read with Regulation 6 (Form 5)
<i>Pre Condition:</i> No notice is required. Default ought to have happened. Additional conditions applicable to home buyers as defined under S.21(6A)(a) and (b).	<i>Pre Condition:</i> Notice should have been issued under S. 8 of the Code. <sup>iii</sup> Period of 10 days should have elapsed from the receipt of the Demand Notice by the Corporate Debtor. There should be no pre-existing disputes.
More than one financial creditor can file a composite application. <sup>iv</sup>	No such corresponding provision.
<i>Scope of adjudication:</i> To adjudicate whether there has been a default and that the debt has remained unpaid.	<i>Scope of adjudication:</i> To adjudicate whether there has been a default in paying the amount due and there is no pre-existing dispute.

Note: The pre-conditions specified herein are in addition to those applicable to both [like limitation, quantum of debt being at least INR 1,00,00,000/- (Rupees One Crore Only) which was earlier fixed as INR 1,00,000/- (Rupees One Lakh Only)]. Further, S. 11 of the Code prescribes for certain category of entities who are disabled from making an application.

### 2. Right as a member of the Committee of Creditor

Financial Creditor	Operational Creditor
<i>Voting Right:</i> Available as a proportion of their debt in the total debt owed by the CD.	<i>Voting Right:</i> Available only if the CoC does not comprise of financial creditors (total debt owed by the CD). <sup>v</sup> Otherwise, if its aggregate due is 10% of the debt owed by the CD, then they have a right to attend the meeting of the CoC. <sup>vi</sup>

Note 1: For home buyers and other categories of financial creditors named in Section 21(6A), they have a right of participation in the meeting of the CoC only through their appointed authorised representative.

Note 2: For submission of claims before the Resolution Professional, there is a further categorization both under Operational Creditors and Financial Creditors as provided under the

Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ('CIRP Regulations').

Operational Creditors		Financial Creditors		Other Creditors
Workmen and Employees Form D (Reg. 9)	Others Operational Creditors Form B (Reg. 7)	Belonging to a Class of Creditors Form CA (Reg. 8A)	Other Financial Creditors Form C (Reg. 8)	Form F (Reg. 9A)

### 3. Treatment under the Resolution Plan and during Liquidation

Financial Creditor	Operational Creditor
<i>Amount to be Offered under Resolution Plan:</i> No set rule	<i>Amount to be Offered under the Resolution Plan:</i> Not less than the amount, if the amounts offered under the Resolution Plan were being paid as per the waterfall mechanism of S.53 of the Code or Not less than Liquidation Value [S.30(2)(b)].
<i>Priority of Payment while disbursing from Liquidation Estate:</i> <b>Priority No. 2:</b> Secured Financial Creditor (not relinquished security interest under S. 52)  <b>Priority No. 4:</b> Unsecured Financial Creditors <b>Priority No. 5:</b> Unsecured Financial Creditor (Remaining portion of unpaid debt after enforcement of security interest under S. 52)	<i>Priority of Payment while disbursing from Liquidation Estate:</i> <b>Priority No. 2:</b> Workmen's dues for a period of 24 months prior to the Liquidation Commencement Date  <b>Priority No. 3:</b> Wages and dues to employees (other than workmen) for a period of 24 months prior to the Liquidation Commencement Date  <b>Priority No. 5:</b> Statutory dues for a period of 24 months prior to the Liquidation Commencement Date  <b>Priority No. 6:</b> Other Operational Creditors

## **Intelligible Differentia in the Distinction: Supreme Court**

This differential treatment and preference granted to 'Financial Creditors' over 'Operational Creditors' was challenged before the Hon'ble Supreme Court of India in the judgment in the case of Swiss Ribbons Pvt. Ltd. and Ors. vs. Union of India.

The classification was contended to be discriminatory and violative of Article 14 of Constitution of India and that there was no intelligible differentia having relation to the objects sought to be achieved by the Code. The Supreme Court had occasion to refer to and analyse the Bankruptcy Law Reforms Committee's Report, Insolvency and Bankruptcy Bill and Insolvency Law Committee's report (the literature that led to the promulgation of the Code).

The Court held that preserving the corporate debtor as a going concern while ensuring maximum recovery for all creditors being the objective of the Code; financial creditors are clearly different from operational creditors. Therefore, it was conclusively held that there is obviously an 'intelligible differentia' between the two which has a direct relation to the objects sought to be achieved by the Code).