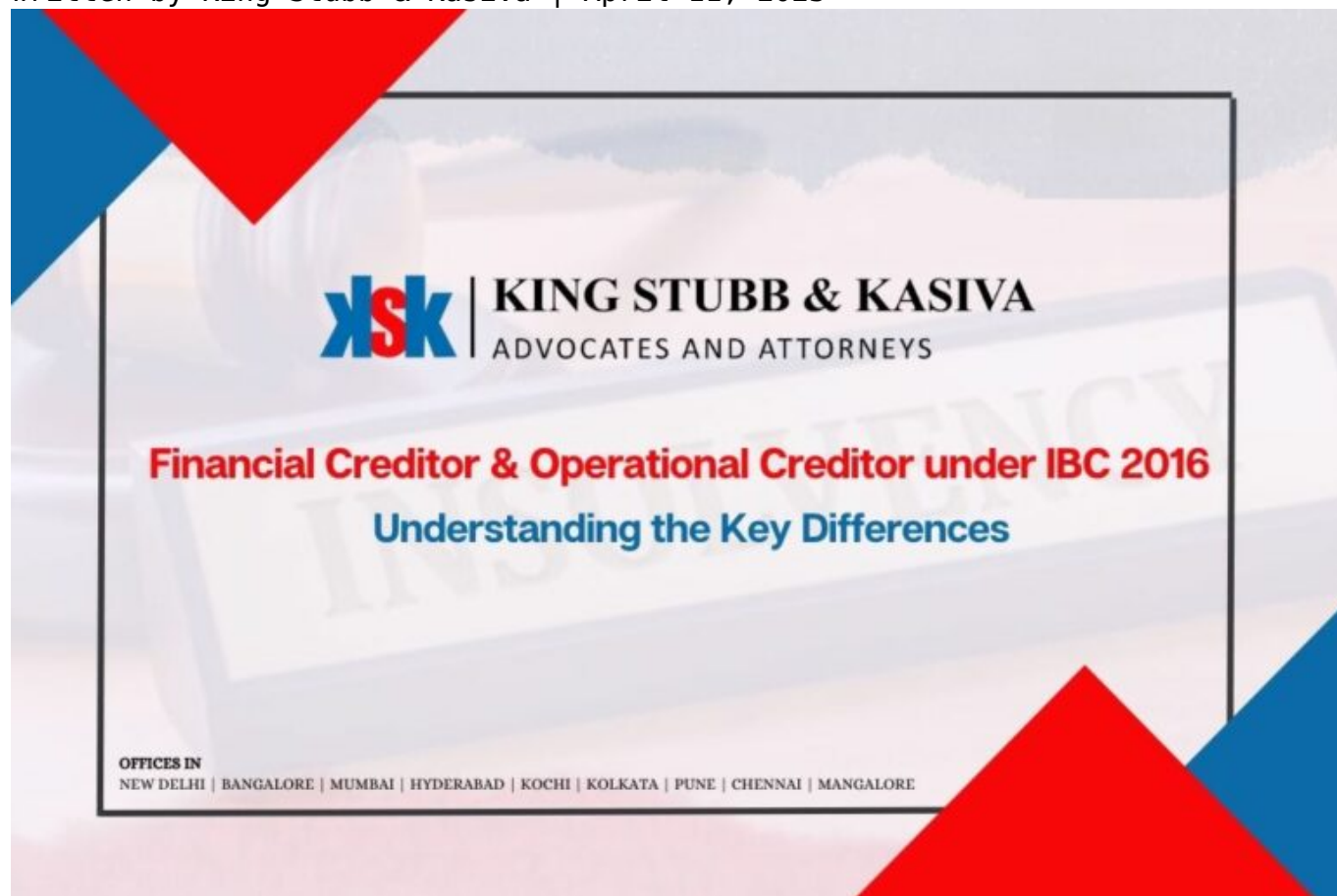


## Understanding the Key Differences Between Financial Creditor and Operational Creditor under IBC 2016

written by King Stubb & Kasiva | April 11, 2023



The Insolvency and Bankruptcy Code, of 2016 is regarded as an important tool for the insolvency and bankruptcy cases of partnerships, companies, firms, and individuals. The objective is to facilitate the resolution of corporate bankruptcy within a limited period.

The Code introduces new and different types of concepts of 'Financial Creditor' and 'Operational Creditor'. In the year 2017 the Hon'ble National Company Law Tribunal, Principal Bench, New Delhi in the case of *Col. Vinod Awasthy v. AMR Infrastructure Limited* where the tribunal had interpreted the definition of 'Operational Creditor' under the IBC Code to discover the applicability of the same to a flat purchaser.[1]

Financial Creditor is defined as "a person to whom the debt is owed including a person to whom such debt has been legally assigned", explained under Section 5(7) of the Insolvency and Bankruptcy Code. Financial debt is defined under section 5(8) of IBC as debt along with interest, which is disbursed against the consideration for the time value of money and also includes any amount raised through the investment in debentures, bonds, or any other form of securities.

There are some of the rights and remedies which are available to financial creditors under the IBC:-

- Initiation of the insolvency process:- Financial creditor can start the insolvency proceedings against a corporate debtor if the amount of default is at one Lakh rupees at least. An application can also be filed for insolvency against the corporate debtor before the National Company Law Tribunal.
- Voting in the Committee of Creditors- It consists of all the financial creditors of the corporate debtor. It plays a crucial role in the insolvency

resolution process and makes all critical decisions related to the insolvency resolution process. Each financial creditor has voting rights in the Committee of Creditors which is based on the amount of the financial debt owed by the corporate debtor.

- Appointment of the resolution professional:- The Committee of Creditors has the power to appoint a resolution professional who will oversee the entire insolvency resolution process. They are responsible for taking all the important steps to ensure the maximization of the value of the assets of the corporate debtor.
- Enforcement of security interest:- A financial creditor can enforce its security interest over the assets of the corporate debtor in case of default. The IBC provides a process for the enforcement of security interests that is time-bound and efficient.
- Participation in the resolution plan: The financial creditor has the right to participate in the resolution plan prepared by the resolution professional. The Committee of Creditors can accept or reject the resolution plan proposed by the resolution professional, and the financial creditor has the right to vote on the plan.
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#### Operational Creditor

An operational creditor is defined as a person to whom the debt is owed which includes the person to whom such debt has been legally transferred, explained under Section 5(20) of the Insolvency and Bankruptcy Code. It refers to the debt which arises out of the provision of goods and services, including employment contracts and any amount which is payable under any law.

The insolvency proceedings can be initiated against a defaulting corporate debtor under the IBC if the debt owed is not paid within a limited period. The IBC provides a simple and quick dispute resolution mechanism for operational creditors to recover their outstanding due amounts from corporate debtors. However, the operational creditor must prove that a default has occurred and the debts owed are operational.

#### Rights and Remedies of Operational Creditor

- Right to initiate insolvency proceedings: - Under Section 9 of IBC, an operational creditor can initiate the insolvency proceedings against the debtor.
- Right to serve demand notice- Under Section 8 of IBC, an operational creditor can serve demand notice to the debtor demanding payment of outstanding debt.
- Right to be informed about the resolution plan- Under section 25(2)(j) of IBC operational creditor has the right to be informed about the resolution plan proposed by the resolution professional.
- Right to attend creditor's meeting- Under section 21(2) of IBC operational creditor has the right to attend the meeting of the committee of creditors

and participate in the decision-making process.

- Right to receive the payment- Operational creditor has the right to receive the payment of the outstanding debt from the debtor, according to the resolution plan approved by the Committee of Creditors.
- Right to file claims- An operational creditor has the right to file the claim against the debtor following the guidelines issued by the Insolvency and Bankruptcy Board of India.
- Remedies of non-payment- If the debtor fails to make the payment of the outstanding debt, the operational creditor has the remedy of filing a petition for winding up the debtor under the Companies Act, 2013 or filing the suit for recovery of the debt under the Civil Procedure Code, 1908.

Difference between Operational Creditor and Financial Creditor

- Definition- Financial creditors are defined as any person who has extended any form of the financial facility to the debtor whereas operational creditors are defined as any person to whom an operational debt is owed.
- Nature of the debt- Financial creditors generally provide credit in some form to the debtor whereas operation creditors provide goods or services to the debtor.
- Priority- Financial creditors are given priority over the operational creditors in the repayment hierarchy in case of liquidation. Financial creditors are paid before operational creditors.
- Insolvency Process- In the insolvency process financial creditors are the part of Committee of Creditors. It takes all the necessary decisions about the insolvency resolution process. Operational creditors are not part of the committee and do not have the right to vote.
- The threshold for Filing- The financial creditors are required to show a minimum threshold of outstanding dues before they can initiate an insolvency process. There is no such threshold for operational creditors.
- Resolution Process- In case of payment delay, financial creditors can trigger an insolvency process against the debtor, whereas the operational creditors have to first send the demand notice to the debtor and wait for a limited time before they can start the insolvency process.
- Representation- The financial creditors are represented by their authorized representatives on the Committee of Creditors. On the other hand, operational creditors have a representative on the Committee of Creditors only if their dues exceed a certain threshold.

The main difference between financial creditors and operational creditors is their priority in the process of repayment hierarchy. Financial creditors are given priority over operational creditors in the case of liquidation.

Different preference is granted to financial creditors over operational creditors and this was challenged before the Apex Court in the case of *Swiss Ribbons Pvt. Ltd and Ors vs Union of India* that it is violative of Article 14 of the Indian Constitution and there was no *intelligible differentia* having relation to the material which are sought to be achieved by the Code.<sup>[2]</sup> The Apex Court had referred to the Bankruptcy Law Reforms Committee's Report, Insolvency and Bankruptcy Bill, and Insolvency Law Committee's report.<sup>[3]</sup> The Court held that preserving the corporate debtor is important while enduring the maximum recovery for all the creditors is the objective of the Code, financial creditors are different from operational debtors.

Conclusion

The Insolvency and Bankruptcy Code 2016 gives the difference between

financial creditors and operational creditors. Financial creditors are those who lend money to a company whereas operational creditors are those who provide the goods and services to a company in their common course of business. The nature of the claim is the main difference between them in the insolvency process. Financial creditors have a primary claim on the assets while operational creditors have a secondary claim. The IBC aims to balance the interests of both types of creditors and ensures a fair and transparent insolvency process for all the parties involved.

To complete a proper corporate insolvency resolution procedure against a debtor, it is important to explain that the creditor fits within the scope and extent of the definition of 'Financial Creditor' according to Section 5(7) and Operational Creditor Section 5(20) of the IBC. In the case of Mukesh Kumar vs. AMR Infrastructure Limited,[4] the tribunals are severe in construing the term of 'Operational Creditor' under the Code and refusing to accept the petitions when the petitioners do not come within the scope of IBC and have other remedies available.

#### FAQs

Can an individual be a financial creditor under IBC?

Yes, the financial creditor is a person to whom the debt is owed, and it includes a person to whom a financial debt has been transferred legally.

What is the basic difference between financial creditor and operational creditor under IBC, 2016?

The primary difference between the two types of creditors is that a financial creditor has extended financial support in the form of loans, advances, or other facilities, while an operational creditor has supplied goods and services to the Corporate Debtor.

What is the role of the Committee of Creditors in the case of Financial and Operational Creditors?

The Committee of Creditors plays an important role in both cases. However, the members of the Committee of Creditors are elected differently for both types of creditors. For financial creditors, the Committee of Creditors is made up of all the financial creditors of the Corporate Debtor, whereas for operational creditors, the Committee of Creditors is made up of members elected by the operational creditor.

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[1]C.P. No. (IB)-10 (PB)/2017.

[2](2019) 4 SCC 17

[3][https://ibbi.gov.in/BLRCReportVol1\\_04112015.pdf](https://ibbi.gov.in/BLRCReportVol1_04112015.pdf)&<https://ibbi.gov.in/uploads/whatsnew/7c9bde175431a4abb8c33bb105e1f2dd.pdf>

[4](C.P No (IB)-30(PB/2017)

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