

# DIFFERENCE BETWEEN OPERATIONAL AND FINANCIAL CREDITORS

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**Editor’s Note:** IBC envisages a creditor-driven process. A creditor is one to whom the debtor owes a ‘debt’, and ‘debt’ as defined in the law is a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt. Therefore, the law creates a unique distinction between financial creditors and operational creditors – defining at different places, their rights, entitlements, roles, and limitations. Accordingly, determination of nature of debt is a preliminary exercise in IBC proceedings. In this piece originally contributed in 2016, the contributor briefly collates the points of difference.

**T**he most awaited, IBC, received President’s assent on May 28, 2016. Section 3(10) of the Code, 2016 defines the term creditor as follows –

*"creditor" means any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor and a decreeholder;"*

The Code, 2016 differentiates between financial creditors and operational creditors. Financial creditors are those whose relationship with the entity is a pure financial contract, such as a loan or a debt security. Operational creditors are those whose liability from the entity comes from a transaction on operations.

We have analyzed the difference between both the terms i.e. financial creditor and operational creditor below:

Particulars	Financial Creditor	Operational Creditor
<b>Meaning</b>	Section 5 (7) - Financial creditor means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to.	Section 5 (20) – Operational creditor means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred.
<b>Meaning of the term “debt”</b>	Section 5 (8) - financial debt means a debt alongwith interest, if any, which is disbursed against the consideration for time value of money and includes items referred to in sub-clauses (a) to (i)	Section 5 (21) - operational debt means a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment of dues arising under any law for the time

		being in force and payable to the Central Government, State Government, or any local authority.
<b>Voting share</b>	Section 5 (28) - Voting right of a financial creditor is based on the proportion of the financial debt owed to such financial creditor. The approval of committee of creditor shall be obtained by a vote of not less than seventy five percent <sup>3</sup> of the voting shares.	Operational creditor shall not have any right to vote at the meeting of committee of creditors.
<b>Initiation of corporate insolvency resolution process</b>	Section 7 (1) – On occurrence of a default, a financial creditor shall either by itself or jointly with other financial creditors may <b>file an application</b> for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority.	Section 8 (1) – On occurrence of a default the operational creditor may, <b>deliver a demand notice</b> of unpaid operational debtor copy of an invoice demanding payment of the amount involved in the default to the corporate debtor. The operation creditor may file an application after the expiry of 10 days from the date of delivery of the notice or invoice demanding payment under sub-section (1) of section 8, if the operational creditor does not receive payment from the corporate debtor or notice of the dispute under sub-section (2) of section 8.
<b>Appointment of IRP</b>	Section 7 (3) - The financial creditor <b>shall</b> along with the application furnish the name of the resolution professional proposed to act as an interim resolution professional.	Section 9 (4) - An operational creditor <b>may</b> propose a resolution professional to act as an interim resolution professional.
<b>Constitution of Committee of Creditors</b>	Section 21 (2) - The committee of creditors shall consist <b>solely of financial creditors</b> , and all financial creditors of the corporate debtor.	Operational creditors shall not form part of committee.
<b>Submission of financial information</b>	Section 215 (2) - A financial creditor <b>shall</b> submit financial information and information	Section 215 (3) - An operational creditor <b>may</b> submit financial information to the information

<sup>3</sup>By virtue of the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, effective from 6<sup>th</sup> June, 2018, the voting percentage has been reduced from 75% to 66% for substantial decisions like approval of Resolution Plan, replacement or removal of Resolution Professional etc., whereas, the minimum threshold for routine matters has been reduced to 51%.

## Difference between Operational & Financial Creditors

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relating to assets in relation to utility  
which any security interest has  
been created.

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Table 2: Differences b/w Financial and Operational Creditor

### Know More . . .

The difference between financial and operational creditors under the Code is not merely surficial – it is fundamental. If the crux of insolvency regime is priorities, the priorities of the two in the distribution waterfall differ, even if both are unsecured. Is this a differentiation, or discrimination?

The differentiation, alongwith certain other provisions of the Code, was challenged before the Supreme Court in a bunch of petitions. In *Swiss Ribbons Ltd. v. Union of India*, the Supreme Court observed that *“A perusal of the definition of ‘financial creditor’ and ‘financial debt’ makes it clear that a financial debt is a debt together with interest, if any, which is disbursed against the consideration for time value of money. It may further be money that is borrowed or raised in any of the manners prescribed in Section 5(8) or otherwise, as Section 5(8) is an inclusive definition. On the other hand, an ‘operational debt’ would include a claim in respect of the provision of goods or services, including employment, or a debt in respect of payment of dues arising under any law and payable to the Government or any local authority.”* And, *“financial creditors generally lend finance on a term loan or for working capital that enables the corporate debtor to either set up and/or operate its business. On the other hand, contracts with operational creditors are relatable to supply of goods and services in the operation of business. Financial contracts generally involve large sums of money. By way of contrast, operational contracts have dues whose quantum is generally less.”* The difference between operational and financial debt/creditors was thus upheld by the Supreme Court.

The most important consideration in determining whether a debt is a financial debt or an operational debt is to “intent of the parties”. Merely because a creditor claims interest for a delayed payment, does not imply that the debt is financial - in such transactions, interest is contemplated as a ‘penalty’ and not ‘returns’. Also, lending for time value of money does not necessarily involve ‘interest’. In order to qualify to be a financial debt, what matters is that the amount was disbursed against time value of money, whether or not expressed in terms of ‘interest’.

Besides financial and operational debts, there can be other types of debts too – however, such other creditors are not entitled to initiate an application under the Code, but can file claims in the specified form.