

**A FINANCIAL DEBT WOULD HAVE TO BE CONSTRUED TO INCLUDE INTEREST FREE LOANS ADVANCED TO FINANCE THE BUSINESS OPERATIONS OF A CORPORATE BODY**

**INTRODUCTION:**

*The Apex Court in its recent decision in **M/s Orator Marketing Pvt. Ltd. vs M/s Samtex Desinz Pvt. Ltd.**<sup>1</sup> held that the definition of a financial debt under Section 5(8) of Insolvency and Bankruptcy Code, 2016, does not expressly exclude an interest free loan. Interest free loans advanced to finance the business operations of a corporate body come within the definition of a financial debt.*

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**FACTS:**

M/s Sameer Sales Private Limited ("**the Original Lender**"), advanced an interest free term loan for an amount of Rs.1.60 crores ("**loan**") to M/s Samtex Desinz Pvt. Ltd., the Respondent, being the Corporate Debtor ("**Corporate Debtor**") for a period of two years, to enable the Respondent to meet its working capital requirement.

The Original Lender thereafter assigned the loan to M/s Orator Marketing Pvt. Ltd., the Appellant. ("**Financial Creditor**").

The loan was due to be repaid by the Respondent in full by 1<sup>st</sup> February, 2020. The Appellant claimed that the Respondent made some payments, however an amount of Rs.1.56 crores remained outstanding.

Thereafter, the Appellant filed a Petition under Section 7 of the Insolvency and Bankruptcy Code, 2016 ("**the IBC**") before the New Delhi Bench, NCLT. The Petition was, however, rejected by the NCLT by a judgment and order dated 23<sup>rd</sup> October, 2020.

The NCLT held that the claim could not be termed as a financial debt nor did the Appellant come within the meaning of financial creditor.

Further, once the Appellant did not come within the meaning of financial creditor, the Appellant became ineligible to file an application under Section 7 of the IBC.

Being aggrieved by the order dated 23<sup>rd</sup> October, 2020 of the NCLT, the Appellant filed an appeal under Section 61 of the IBC before the NCLAT.

The NCLAT affirmed the order dated 23<sup>rd</sup> October, 2020, of the NCLT and dismissed the appeal on 8<sup>th</sup> March, 2021 ("**impugned order**").

Thereafter, the Appellant preferred an appeal before the Apex Court against the impugned order.

**ISSUE FOR CONSIDERATION:**

The main issue for consideration before the Apex Court was:

Whether an interest free loan would come within the ambit of section 5(8) of the IBC?

**JUDGMENT:**

The Apex Court opined that the impugned order, affirming the order of the NCLT was

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<sup>1</sup> Civil Appeal No. 2231 of 2021

patently flawed. It was further opined that both the NCLAT and NCLT misconstrued the definition of 'financial debt' under Section 5(8) of the IBC, by reading the same in isolation and out of context.

It was observed that while construing and/or interpreting any statutory provision, the legislative intent of the statute must be looked into. The intention of the statute would have to be found in the words used by the legislature itself. In case of doubt, it would be safe to look into the object and purpose of a statute. Each word, phrase or sentence would have to be construed in the light of the general purpose of an act, as has been observed in a plethora of judgments of the Apex Court.

The Apex Court relied on the judgement of *Pioneer Urban Land and Infrastructure Ltd. Vs. Union of India*<sup>2</sup>, where it was held that individuals who were debenture holders and fixed deposit holders could also be financial creditors and could initiate a Corporate Resolution Process under the IBC.

The Apex Court, relied on section 5(8) of the IBC and observed that the NCLT and NCLAT had overlooked the words "if any" which could not have been intended to be otiose. 'Financial debt' would mean outstanding principle due in respect of a loan and would also include interest thereon, if any interest was payable. If there was no interest payable on the loan, only the outstanding principal would qualify as a financial debt.

It further observed that both the NCLAT and the NCLT had failed to notice clause (f) of Section 5(8) of the IBC, where the term 'financial debt' would include any amount raised under any other transaction, having the commercial effect of borrowing.

The trigger for initiation of the Corporate Insolvency Resolution Process by a Financial Creditor under Section 7 of the IBC is the occurrence of a default by the Corporate Debtor. 'Default' means non payment of the debt in whole or in part when the debt became due and payable. The term debt means a liability or obligation in respect of a claim which is due from any person and includes financial debt and operational debt. The definition of 'debt' is expansive and the same *inter alia* includes financial debt. The definition of 'Financial Debt' in Section 5(8) of the IBC does not expressly exclude an interest free loan. 'Financial Debt' would have to be construed to include interest free loans advanced to finance the business operations of a corporate body.

The appeal was allowed and the judgment and the impugned order was set aside.

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*The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.*

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<sup>2</sup> (2019) 8 SCC 416