

## Interest is not a *sine qua non* for a debt to be considered as a 'financial debt' under the Insolvency and Bankruptcy Code, 2016.

On July 26, 2021, a two-judge bench of the Supreme Court of India held, in the case of *Orator Marketing Private Limited vs. Samtex Desinz Private Limited*<sup>1</sup>, the definition of 'financial debt' in Section 5(8) of Insolvency and Bankruptcy Code, 2016 ("IBC") does not expressly exclude an interest free loan and would have to be construed to include interest free loans advanced to finance the business operations of a corporate body.

### Brief Facts & Procedural History

1. Sameer Sales Private Limited ("SSPL") advanced a loan of INR 1.60 crores to Samtex Desinz Private Limited ("SDPL/Respondent") for a period of two years to enable the Respondent to meet its working capital requirement ("Loan"). Subsequently, SSPL assigned the Loan to Orator Marketing Private Limited ("OMPL/Appellant"). According to the Appellant, the Loan was due to be paid in full on or before February 1, 2020. While some part payments were made by Respondent, OMPL submitted that INR 1.56 crores continued to remain outstanding.
2. In view of the above, OMPL filed an application under Section 7 of the IBC before the Hon'ble National Company Law Tribunal, New Delhi ("NCLT") seeking initiation of CIRP against SDPL, which was rejected by NCLT on the ground that since Loan was interest free, the same could not be termed as a 'financial debt' under Section 5(8) of the IBC ("NCLT Order"). The NCLT Order was challenged before the Hon'ble National Company Law Appellate Tribunal, New Delhi ("NCLAT"). However, the appeal was dismissed and the NCLAT Order was upheld on the aforementioned ground as that of the NCLT ("NCLAT Order").
3. Being aggrieved by the NCLAT Order, OMPL filed the present appeal before the Hon'ble Supreme Court of India ("Hon'ble Supreme Court") under Section 62 of the IBC.

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

## Issue

The issue before the Hon'ble Supreme Court was whether a person who gives a term loan to a Corporate Person, free of interest, on account of its working capital requirements is not a Financial Creditor<sup>2</sup>, and therefore, does not qualify to initiate the Corporate Resolution Process under Section 7 of the IBC?

## Analysis & Findings of the Supreme Court

1. The Hon'ble Supreme Court held that the NCLAT Order affirming the NCLT Order was patently flawed and observed that the definition of 'financial debt' as per Section 5 (8) of the IBC has been misconstrued and read in isolation and out of context.
2. In arriving at the aforementioned finding the Hon'ble Supreme Court stated that while construing and/or interpreting any statutory provision, the legislative intent of the statute, the object and purpose of the statute or the reason and spirit for the enactment of such statute must be looked into. Further, it was observed that each word, phrase or sentence ought to be construed in the light of the general purpose of the statute itself. The Hon'ble Supreme Court observed that when the meaning of a certain provision in a statute has to be considered, the provision must be read in its context and as a whole and the previous position of law, general scope and ambit of the statute and the mischief it sought to remedy are also relevant factors to be considered.
3. The definition of 'financial debt' as per Section 5 (8) of the IBC cannot be read in isolation and without considering other relevant definitions, particularly, the definition of 'claim' in Section 3(6), 'corporate debtor' in Section 3(8), 'creditor' in Section 3(10), 'debt' in Section 3(11), 'default' in Section 3(12) and 'financial creditor' in Section 5(7) together with Sections 6 and 7 of the IBC. The Hon'ble Supreme Court relied on the definition of 'financial debt' under Section 5 (8) of the IBC which means "a debt along with interest if any which is disbursed against the consideration of the time value of money and includes money borrowed against the payment of interest, as per Section 5 (8) (a) of the IBC" and held that the NCLT and the NCLAT have overlooked the words "***if any***" which could not have been intended to be otiose. Therefore, it was held that a 'financial debt' would mean outstanding principal due in respect of a loan and would also include interest thereon. However, if no interest were payable on the loan, only the outstanding principal amount would qualify as a 'financial debt' under the IBC.
4. In addition, the Hon'ble Supreme Court also observed that both NCLAT and NCLT have failed to notice clause(f) of Section 5(8) of IBC, according to which a 'financial debt' includes any amount raised under any other transaction, having the commercial effect of borrowing. The Hon'ble Supreme Court held that clauses (a) to (i) of Section 5 (8) are apparently illustrative and not exhaustive. The legislature has the power to define a word in a statute and that such definition may be restrictive or extensive. However, when the word is defined to include something, then such definition is *prima facie* extensive.
5. In conclusion, the Hon'ble Supreme Court held that having regard to the aim, object and the scheme of the IBC, there was no discernible reason why a term loan to meet the financial requirements of a corporate debtor for its operation, which obviously has the commercial effect of borrowing, should be excluded from the purview of a financial debt. It has been held that the definition of 'debt' is also expansive and the same includes inter alia financial debt. The definition of 'financial debt' in Section 5(8) of 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.

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<sup>2</sup> As defined under Section 5(7) of the IBC

6. Accordingly, the appeal filed by OMPL was allowed by the Hon'ble Supreme Court and the NCLT Order and the NCLAT Order were set-aside. Additionally, the Hon'ble Supreme Court also directed that the application filed by OMPL before the Hon'ble NCLT would stand revived and ought to be considered afresh in accordance with the law and the findings in the present case.

## Conclusion

Since the enactment of the IBC, the component of 'time value of money' in the definition of 'financial debt' under Section 5(8) of the IBC was considered an essential ingredient in determining whether a debt is in fact a financial debt under the purview of the IBC. By way of the present judgement, the Hon'ble Supreme Court has clarified that a 'financial debt' for the purposes of the IBC need not necessarily be a disbursement with an interest component and the said requirement is not a *sine qua non* for a 'financial debt' under the IBC.

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