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INSOLVENCY & BANKRUPTCY

Determination of Financial versus Operational Debt in Invoice Financing Transactions Under the Insolvency and Bankruptcy Code, 2016

The intersection of supply chain financing and insolvency law has increasingly become a fertile ground for jurisprudential debate, particularly concerning the classification of creditors and the validity of unregistered security interests. The National Company Law Tribunal, Amaravati Bench, had occasion to examine these intricate questions in Kushal Finnovation Capital Private Limited v. Rajesh Chillale, Interim […]

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The intersection of supply chain financing and insolvency law has increasingly become a fertile ground for jurisprudential debate, particularly concerning the classification of creditors and the validity of unregistered security interests. The National Company Law Tribunal, Amaravati Bench, had occasion to examine these complex questions in Kushal Finnovation Capital Private Limited v. Rajesh Chillale, Interim Resolution Professional of Kallam Brothers Cottons Private Limited and Others, decided on 29 April 2026, in Interlocutory Application No. IA (IBC)/79/2026 arising out of Company Petition No. CP (IB)/2/7/AMR/2025. The case presents a nuanced exposition on whether invoice financing constitutes financial debt or operational debt, and whether a contractual lien clause, unaccompanied by registered charge documents, can confer secured creditor status upon a claimant during the Corporate Insolvency Resolution Process.

The Applicant before the Tribunal was Kushal Finnovation Capital Private Limited, which had granted “Invoice Financing–Dual Borrower” facilities to three cotton suppliers, namely Vijaya Sai Traders, Sri Mahalakshmi Enterprises, and Sri Lakshmi Traders. On 16 November 2023, the Applicant executed three separate Credit Facility Agreements with each supplier, wherein Kallam Brothers Cottons Private Limited, the Corporate Debtor, acted as guarantor. Each facility carried a sanction limit of three crore rupees, a tenure of twelve months, a ninety-day cycle, and an interest rate of 15.5 per cent per annum. The facility was structured as supply chain financing, disbursed directly to the suppliers for the purchase of cotton by the Corporate Debtor, and the Corporate Debtor undertook the obligation to repay the Applicant. The agreements contained an event of default clause and, significantly, Clause 5.1, which purported to grant the lender “control and lien over all the assets of the Guarantor(s)” along with a right to set off and combine accounts.

The Corporate Debtor was admitted to the Corporate Insolvency Resolution Process on 25 August 2025, following which the Interim Resolution Professional issued a public announcement inviting claims. The Applicant submitted its claim on 11 September 2025 for a sum of Rs. 5,33,99,437/-, which the IRP admitted but classified as an “unsecured financial creditor.” Approximately two months later, the Applicant conducted an internal review and asserted that its claim had been erroneously filed as unsecured due to an inadvertent clerical error by a junior finance team member. By its letter dated 25 November 2025, the Applicant sought reclassification as a secured financial creditor, relying upon Clause 5.1 of the Credit Facility Agreements and contending that the financed cotton and related receivables formed the basis of a subsisting security interest. The IRP responded seeking clarifications regarding no-objection certificates from existing working capital lenders, charge-ceasing agreements, and registration particulars with the Registrar of Companies. The Applicant reiterated its position by letter dated 28 November 2025, asserting that the duty to register any charge lay squarely with the Corporate Debtor under Section 77 of the Companies Act, 2013, and that the absence of registration did not vitiate the contractual lien. The IRP, however, rejected the reclassification request on 6 December 2025, prompting the Applicant to file the present Interlocutory Application under Section 60(5) of the Insolvency and Bankruptcy Code, 2016, seeking reclassification, a stay on Committee of Creditors meetings, and consequential reliefs.

The Applicant’s submissions before the Tribunal were anchored in the proposition that the transaction was fundamentally a financial debt within the meaning of Section 5(8) of the Code, involving a genuine disbursement against the consideration for the time value of money. It was argued that supply chain financing is distinct from general working capital loans, as the lender’s security is intrinsically tied to specific trade flows and receivables. The Applicant placed reliance upon the decision in Paschimanchal Vidyut Vitran Nigam Limited v. Raman Ispat Private Limited to contend that the scope of the application was limited to reclassification and that the IRP could not, without amending pleadings, seek to recharacterize the debt as operational. It was further submitted that Regulation 21 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 prescribes evidentiary standards for proving security interest only in liquidation, and that no corresponding provision exists in the CIRP Regulations, thereby rendering non-registration under Section 77 of the Companies Act, 2013 irrelevant during the resolution process. The Applicant also distinguished the precedents cited by the IRP, arguing that the present case involved actual disbursements under executed loan agreements, unlike pure factoring arrangements.

The IRP, in his counter-affidavit and written arguments, mounted a strong challenge on both the nature of the debt and the existence of a perfected security interest. It was contended that the transaction was, in substance, bill discounting or invoice financing, where the Applicant merely stepped into the shoes of the cotton suppliers. The Corporate Debtor’s liability did not arise from any borrowing of money but from the purchase of goods in the ordinary course of business, thereby attracting the definition of “operational debt” under Section 5(21) of the Code. The IRP relied extensively upon the recent judgment of the National Company Law Appellate Tribunal in Canbank Factors Limited v. Brijesh Singh Bhaduria, wherein it was held that discounting of trade receivables retains the character of operational debt and that the financier merely substitutes the supplier for recovery

purposes. Further reliance was placed upon Minion Ventures Private Limited v. TDT Copper Limited and Phoenix ARC Private Limited v. Spade Financial Services Limited to emphasise that the real nature of the transaction, rather than its label, determines creditor status, and that unregistered or unperfected charges cannot sustain a claim of secured creditor status. The IRP also cited Unity Small Finance Bank Limited v. Sripatham Venkatasubramanian Ramkumar and V. Jaisankar v. M. Suresh Kumar to emphasise that secured status is contingent upon a registered charge under Section 77 of the Companies Act, 2013, and that a generic lien clause or sanction letter does not amount to a transaction creating a security interest in identifiable assets. It was pointed out that HDFC Bank and Axis Bank held prior registered charges over the Corporate Debtor's assets, and that no charge registration, hypothecation deed, mortgage, or CERSAI record was produced by the Applicant.

During the course of hearings, the Tribunal framed two pivotal issues for determination: first, whether the debt claimed by the Applicant constituted a financial debt or an operational debt under the Code; and second, whether the Applicant possessed any valid security interest over the assets of the Corporate Debtor.

In its analysis, the Tribunal examined the definition of "financial debt" under Section 5(8) of the Code, with specific reference to clause (e), which includes "receivables sold or discounted other than any receivables sold on non-recourse basis." The Tribunal observed that the Applicant itself had asserted that its security was confined to the specific assets financed, namely the cotton and related receivables, and that its recovery was limited to those assets. Applying the ordinary meaning of "non-recourse," the Tribunal held that since the Applicant's satisfaction could be obtained only out of the particular collateral given and not out of the Corporate Debtor's other assets, the facility was effectively on a non-recourse basis. Consequently, the debt did not fall within the inclusive definition of financial debt under Section 5(8)(e). The Tribunal further noted that the transaction, viewed in its true commercial substance, was nothing but the discounting of trade invoices raised by suppliers for cotton supplied in the ordinary course of the Corporate Debtor's business. Following the ratio of Canbank Factors Limited, the Tribunal concluded that the debt was operational in nature, arising from the procurement of goods and squarely falling within Section 5(21) of the Code.

On the question of security interest, the Tribunal held that no valid, identifiable, or enforceable security interest had been established. The Applicant's reliance upon Clause 5.1 of the Credit Facility Agreements was found to be insufficient, as the clause constituted a general lien over unspecified assets rather than a created charge over identifiable property. The Tribunal emphasised that registration of a charge is public notice in rem, and that even if a charge were assumed to exist, it would be subordinate to the prior registered charges held by HDFC Bank and Axis Bank. The Tribunal also noted that the charge, if any, would crystallise only upon the occurrence of an event of default and service of notice under Clause 4.2 of the agreements, which the Applicant had failed to demonstrate. Additionally, the Tribunal observed that the suppliers who had executed the Credit Facility Agreements were represented by individuals who were also Directors or Managing Director of the Corporate Debtor at the material time, thereby potentially attracting related-party considerations.

The Tribunal disposed of the Interlocutory Application without granting the reliefs sought. In view of the IRP's submission that he was actively re-examining the nature and categorisation of the Applicant's claim and intended to file a revised Committee of Creditors constitution if warranted, the Tribunal deemed it inappropriate to pass any definitive order on reclassification. The matter was left open for the IRP to take an appropriate decision in accordance with law, and the prayer for stay of Committee of Creditors meetings was declined.

The judgment in Kushal Finnovation Capital Private Limited v. Rajesh Chillale is a significant reminder that in insolvency proceedings, nomenclature and contractual labels yield to commercial substance. The decision reinforces the principle that invoice financing and supply chain facilities, when structured as non-recourse receivable discounting, retain the character of operational debt, and that secured creditor status cannot be claimed through unregistered, unperfected, or broadly worded contractual liens in the absence of identifiable charge creation and registration. For practitioners and financiers operating in the trade finance ecosystem, the ruling highlights the imperative of perfecting security interests through proper documentation and registration, lest their claims be relegated to the unsecured or operational category in the crucible of corporate insolvency.

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