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Defining Financial Debt: NCLT Judgment Confirms IBC Cannot Be Invoked for Recovery of Profit-Linked Investments

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Introduction

In a ruling that reinforces the strict contours of what qualifies as a financial debt under the Insolvency & Bankruptcy Code, 2016 (IBC), the National Company Law Tribunal (NCLT), New Delhi Bench, has dismissed a Section 7 application filed by Modern Solar Private Limited against Claro Energy Private Limited[1]. The Tribunal held that the ?20 lakh advanced by Modern Solar was not a loan but an investment made towards a profit-sharing venture, and therefore lacked the essential element of time value of money required under Section 5(8) of the Code. By doing so, the NCLT once again highlights that the IBC framework cannot be invoked to recover disputed business investments or to convert failed commercial arrangements into insolvency proceedings. This judgment clarifies the distinction between investment and debt and is also a caution against attempts to misuse the insolvency mechanism for purposes outside its legislative intent.

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Background of the Case

The dispute between Modern Solar Private Limited ("Modern Solar") and Claro Energy Private Limited ("Claro Energy") originates from a commercial arrangement linked to the PHED Sitamarhi Project in Bihar. In early 2013, Claro Energy approached Modern Solar seeking financial support for the execution of this government project. Responding to the request, Modern Solar transferred a total of ?20,00,000 through two RTGS payments dated 02.03.2013 and 19.03.2013.

While Modern Solar later asserted that this amount constituted a loan extended for the project's working capital, Claro Energy maintained that the funds were an investment made in return for a profit-sharing arrangement. As the project faced delays and the amount remained unpaid, Modern Solar demanded repayment. Claro Energy issued a cheque dated 22.02.2014 for ?20 lakhs, but the cheque was dishonoured due to insufficient funds.

Following this, Modern Solar initiated **winding-up proceedings** under Sections 433 and 434 of the Companies Act, 1956 before the Delhi High Court. In view of amendments introduced through the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, the High Court transferred the petition to the NCLT on **07.10.2022**, where it was re-registered as a transferred company petition. The NCLT, in April 2023, directed Modern Solar to file an appropriate application under either Section 7 or Section 9 of the IBC.

Pursuant to these directions, Modern Solar filed an interlocutory application seeking to treat the transferred petition as a **Section 7 IBC application**, asserting that the unpaid amount constituted a financial debt. Claro Energy opposed this, maintaining that the amount was a capital investment in a joint commercial venture, not a loan.

This factual matrix ultimately led to the adjudication on whether the amount advanced satisfied the definition of a financial debt under Section 5(8) of the IBC an issue central to the maintainability of the insolvency petition.

Key Issues:

1. Whether the ?20 lakh advanced by Modern Solar qualifies as a "financial debt" under Section 5(8) of the IBC?
2. Whether the transaction was a loan or an investment made on a profit-sharing basis?
3. Whether the email exchanges amounted to a clear acknowledgment of debt or only discussions on possible restructuring?
4. Whether the cheque issued by Claro Energy represented repayment of a loan or payment for material supplied?
5. Whether a Section 7 application is maintainable when the underlying claim arises from an investment and not a financial debt?

NCLT's Analysis and Findings

The Tribunal conducted a detailed review of the email correspondence and held:

1. Transaction Was Originally Structured as an Investment

The applicant's email dated 04.10.2013 expressly acknowledged that the funds were provided as an investment linked to profit-sharing, thereby undermining the claim that the amount was ever intended to be a loan.

2. Loan Restructuring Discussions Lacked Finality

The email dated 06.02.2014, relied upon by Modern Solar, did not evidence an existing loan. Instead, it merely reflected a proposed restructuring of the investment to enable a premature exit. The respondent's subsequent email dated 08.03.2014 confirmed that this restructuring was only an exploratory option and was never concluded or agreed upon.

3. No Time Value of Money- Core Ingredient Missing

To qualify as a "financial debt" under Section 5(8) of the IBC, the disbursement must carry the time value of money. The Tribunal observed that the alleged interest rate of 18% had no contractual basis and was never part of a concluded financial arrangement. Accordingly, the transaction failed to meet the statutory test.

4. Cheque Issuance Did Not Prove Loan Repayment

The cheque dated 22.02.2014 which the applicant claimed was issued towards repayment of a loan was referenced in email communications dated 18.04.2014 as being related to material supplied for the project. This inconsistency further weakened the applicant's narrative of a loan transaction.

5. Judicial Precedents Support Investment Classification

The Tribunal relied on the decision in Jagbasera Infratech Pvt. Ltd. v. Rawal Variety Construction Ltd.[2],where the NCLAT held that amounts invested in a joint venture or profit-sharing project **do not fall within the definition of "financial debt"** under Section 5(8). The Appellate Tribunal had clearly observed that investments made in the capacity of a promoter or investor cannot be treated as financial debt. This principle was reaffirmed in **Chiragsala Sales Pvt. Ltd. v. Vaishno Devi Traders Pvt. Ltd.[3]**, reinforcing that contributions made for profit-sharing in a commercial venture cannot trigger insolvency proceedings under Section 7 of the IBC.

Final Holding

The Tribunal held that the ?20 lakh advanced by Modern Solar constituted investment capital in a profit-sharing commercial venture, and not a loan carrying time value of money. As no document or conclusive evidence was produced to establish the existence of a financial debt under Section 5(8) of the IBC, the applicant could not be treated as a financial creditor. Given that profit-linked investments do not fall within the ambit of financial debt, the Section 7 application was found to be **not maintainable** and was accordingly dismissed, with no order as to costs.

Significance of the Judgment

This decision strengthens key principles governing insolvency proceedings under the IBC:

1. **Narrow Interpretation of "Financial Debt"**: The ruling reinforces that the IBC cannot be used to recover investments. Only transactions embodying time value of money and a clearly established obligation of repayment fall within Section 5(8).
2. **Profit-Linked Investments Are Not Financial Debt**: Funds infused as capital for a project, with returns dependent on project success, constitute commercial investments, not debts enforceable through Section 7 proceedings.
3. **Conduct and Correspondence Determine the True Nature of Transactions**: The Tribunal emphasised that email exchanges and parties' contemporaneous communications are crucial indicators of whether the transaction was an investment or a loan.
4. **Safeguards Against Misuse of the Insolvency Framework**: By rejecting the attempt to convert a failed business arrangement into an insolvency claim, the judgment affirms that the IBC is a mechanism for insolvency resolution, not a tool for recovery of disputed commercial dues.

Author's View: Protecting the Integrity of the IBC

The NCLT's decision aligns precisely with the developing legal principles (**jurisprudence**) intended to safeguard the Insolvency and Bankruptcy Code (IBC) from being misused as a **debt recovery tool**. The Tribunal correctly and effectively distinguished between two critical concepts:

- **A commercial investment**.
- **A financial debt with contractual repayment obligations**.

Investments, by their nature, entail inherent business risks; they cannot be retrospectively converted, due to subsequent losses or "mere hindsight," into fictional "loans" solely to invoke insolvency proceedings. This ruling powerfully reinforces the fundamental purpose of the IBC: it is designed as a mechanism for resolving insolvency, not for settling general commercial disputes or for enforcing the recovery of investment capital.

For more details, write to us at: contact@indialaw.in

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[1] I.A. (CO. ACT) NO.: 49/ND/2024 IN T.P. (CO. ACT) NO.: 53/PB/2022 Old CP No. 39/2016

[2] CA (AT)(Ins) No. 150 of 2019

[3] CP (IB)/33/7/GB/2022

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