

‘CRITICAL SUPPLIES’ UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

A corporate insolvency resolution process (“CIRP”) under the Insolvency and Bankruptcy Code, 2016 (“Code”) involves a delicate balance between the interests of various stakeholders, which must be collectively aligned towards the revival of a corporate debtor. One category of such stakeholders is suppliers to the corporate debtor. The continuance of supplies to a corporate debtor may be the cornerstone to ensuring its continued existence and functioning as a going concern¹, which ultimately ensures a better realization its creditors.² At the same time, a delicate balance must be built into an insolvency framework to adequately incentivize suppliers to support a corporate debtor in distress where payments may for goods and services may not be forthcoming.

I. Introduction of the concept of ‘critical supplies’ under the Code

The Code, from its inception provided protection to a corporate debtor as regards the supply of ‘essential goods and services’. This protection is couched under Section 14 (2) of the Code, which provides as under:

“(2) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.”³

The term ‘essential goods or services’ is highly limited in scope, covering solely electricity, water, telecommunication services, and information technology services, solely to the extent that such supplies do not constitute a direct input to the output produced or supplied by the corporate debtor.⁴ Corresponding to this benefit of continued supply provided to the corporate debtor, amounts due to the suppliers of ‘essential goods or services’ are included within the definition of insolvency resolution process costs⁵ and are accordingly required to be mandatorily paid in priority under a resolution plan in a CIRP⁶ or out of the liquidation process of a corporate debtor as the case may be.⁷

The extremely narrow scope of ‘essential goods or services’ and the specific exclusion of goods or supplies which are utilized as direct inputs to goods or services provided by a corporate debtor, posed serious concerns in CIRPs, as suppliers of necessary goods and services no matter how necessary such goods and services could be to the actual running of a corporate debtor as a going concern, could still proceed to terminate their supplies during the CIRP of a corporate debtor. Accordingly, the economic value associated with keeping a corporate debtor running as a going concern could often be depleted as a result of exercise of such contractual rights by suppliers of non-essential goods and services.

The need for introducing flexibility in the determination of ‘essential goods or services’ came to be noted in the report of the Insolvency Law Committee Report released in May 2018, wherein it was suggested that a resolution professional could make a suitable application before the jurisdictional National Company Law Tribunal (“NCLT”) for continuation of supply of essential goods or services other than as specified under the CIRP Regulations, and the NCLT take a decision on the determination of such supply based on the facts and circumstances of each case.⁸

¹ The duty to maintain a corporate debtor as a going concern is imposed on the interim resolution professional, and thereafter on the resolution professional under Section 20 (1) read with Section 23 (2) of the Insolvency and Bankruptcy Code, 2016.

² Report of Bankruptcy Law Reforms Committee, at p. 15.

³ Section 14 (2), Insolvency and Bankruptcy Code, 2016.

⁴ Regulation 32, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

⁵ Regulation 31 (1), Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

⁶ Section 30 (2)(a), Insolvency and Bankruptcy Code, 2016.

⁷ Section 53 (1)(a), Insolvency and Bankruptcy Code, 2016.

⁸ Report of Insolvency Law Committee, 2018, at para 5.14 and 5.15.

Accordingly, this issue was discussed at length in the discussion paper on the corporate insolvency resolution process dated November 3, 2019 released by the Insolvency and Bankruptcy Board of India (“IBBI”), wherein it was recommended that a second category of essential services should be added to Regulation 32 of the CIRP Regulations, which shall be services considered as essential by the interim resolution professional/resolution professional for running a corporate debtor as a going concern. The supply of this second category of services would be subject to the condition that the corporate debtor pays for their current consumption during the CIRP.⁹

This was followed by the introduction of the concept of critical supplies under Section 14 (2A) of the Code *vide* the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 (thereafter replaced by the Insolvency and Bankruptcy Code (Amendment) Act, 2020)). Section 14 (2A) of the Code provides as under:

“(2A) Where the interim resolution professional or resolution professional, as the case may be, considers the supply of goods or services critical to protect and preserve the value of the corporate debtor and manage the operations of such corporate debtor as a going concern, then the supply of such goods or services shall not be terminated, suspended or interrupted during the period of moratorium, except where such corporate debtor has not paid dues arising from such supply during the moratorium period or in such circumstances as may be specified.”

Accordingly, with the introduction of Section 14 (2A) of the Code, it is open for an interim resolution professional/resolution professional to determine that the supply of certain goods and services are critical to protect and preserve the value of a corporate debtor, and to manage its operations as a going concern, and then such supplies cannot be terminated unless there is non-payment of dues arising from such supply during the moratorium period.

II. Issues with the concept of ‘critical supplies’

(A) *Lack of guidance on determination of ‘critical supplies’*

Presently, Section 14 (2A) of the Code solely states that critical supplies can be considered as such if they are critical to (i) protect and preserve the value of a corporate debtor; and (ii) to manage its operations as a going concern. It is relevant to note these categories can cover an entire gamut of supplies, however, the Code does not provide any guidance on how a resolution professional/interim resolution professional may determine what is ‘critical’.

To ensure consistency in broad approaches across CIRPs, and to prevent uncertainty and confusion in the process of determination, it may be helpful to devise certain common tests to enable the easier determination of ‘criticality’. In fact, certain tests in this regard were suggested by the Insolvency Law Committee, 2020, as reproduced below:

“8.17. The supplies that would be considered critical should be identified by the resolution professional, who is entrusted with the responsibility of running the corporate debtor as a going concern. In identifying critical supplies, the resolution professional should consider factors such as whether the supplies have a significant and direct relationship with keeping the corporate debtor running as a going concern, and whether the supplies may be replaced easily or efficiently.”

Such broad principles may be formalized and should be made available to interim resolution professionals/resolution professionals to establish certain common practices for understanding the term criticality, which may of course thereafter be applied as per the facts and circumstances of each

⁹ Discussion paper on the Corporate Insolvency Resolution Process dated November 3, 2019, at para 19.

individual case. This could help create greater certainty in the determination of critical supplies. Further, such common principles could reduce the risk of determinations by resolution professionals being open for judicial challenge, thereby fulfilling the regulatory intent of behind affixing the role of determination of ‘criticality’ on the resolution professionals, rather than the NCLTs (*as suggested originally by the Insolvency Law Committee in 2018*), i.e., reducing the burden of the already overworked NCLT.¹⁰

(B) *Demarcation between essential supplies and critical supplies: Muddied waters*

Problem statement

Originally, ‘critical supplies’ were recommended to be included as a part of ‘essential supplies’ under Regulation 32 of the CIRP Regulations.¹¹ However, ultimately, critical supplies were included under Section 14 (2A) of the Code. It is relevant to note that there is a natural overlap between what is ‘essential’ and what is ‘critical’ under the Code. Essential supplies including electricity, water, telecommunications and information technology services could of course also be argued to be critical to protect and preserve the corporate debtor, and to run the corporate debtor a going concern.

Further, suppliers would be more incentivized to take the aforesaid argument, to fit their supplies within the bracket of ‘critical supplies’ to avail the benefit of regular payments under Section 14 (2A) of the Code for the goods and services provided by them, and the corresponding right to walk away and discontinue supply in the event of payment default. Within the Code, no similar right is available in case of essential supplies, as long as payments for the same are accrued as insolvency resolution process costs – however, admittedly, courts have often ordered for regular payment of amounts due to essential suppliers during CIRPs as well, on the grounds that no supplier should be required to supply for free.¹² However, in the absence of an express prescription regarding such payment, obtaining regular payments for essential supplies may end up becoming a subject matter left up to the discretion of the court, rather than an assured benefit.

On the other hand, corporate debtors may often be incentivized to argue that the essential supplies listed under Section 14 (2) do not form a part of critical supplies under Section 14 (2A), as this would prevent the imposition of often heavy payments on the corporate debtor, during the course of the CIRP, and allow for such costs to continue accruing as corporate insolvency resolution process costs. The divergent treatment of essential supplies and critical supplies within the Code accordingly sets the stage for varying opinions between suppliers and resolution professionals regarding the characterization of supplies.

Unfortunately, there is little guidance within the Code for situations of overlap between these categories. Some limited guidance is provided by Regulation 32 of the CIRP Regulations which excludes goods or inputs which constitute a ‘direct input’ to the output produced or supplied by the corporate debtor. However, the term ‘direct input’ itself is vague. The explanation appended to Regulation 32 of the CIRP Regulations only explains as under:

“Water supplied to a corporate debtor will be essential supplies for drinking and sanitation purposes, and not for generation of hydro-electricity.”

However, this explanation does not provide guidance on what business is in fact carried out by the corporate debtor – has water been excluded from essential supplies because the corporate debtor is carrying out the business of providing hydroelectricity? Would the situation be any different if a portion of the hydroelectricity generated by the corporate debtor is utilised for powering its own office

¹⁰ Report of Insolvency Law Committee, 2020, at para 8.15.

¹¹ Discussion paper on the Corporate Insolvency Resolution Process dated November 3, 2019, at Annexure.

¹² Dakshin Gujarat VIJ Company v. M/S ABG Shipyard Limited, Company Appeal (AT) (Insolvency) No. 334 of 2017.

premises or factory or plant– would this portion of water supply be treated as an essential supply given that it is not linked to any output provided by the corporate debtor? In such a situation, it may be arguable that water is not a ‘direct input’ to the output produced or supplied by the corporate debtor – and accordingly, water could constitute an essential supply protected under Section 14 (2) of the Code, and amounts payable in respect thereof would not be payable on a current basis.

Under the same example above, it could be possible for a supplier to argue that the water supplied for generating hydroelectricity to power the office premises of the corporate debtor or to power its machines is being utilized to protect and preserve the corporate debtor and run the corporate debtor as a going concern, and accordingly, it falls under Section 14 (2A) of the Code, and requires current payments. Therefore, multiple interpretations for the characterization of the same supply are possible within the plain language of the Code.

Regulatory intent

In order to resolve such a conflict, it is important to look at the scope and ambit of services proposed to be covered by Section 14 (2) and Section 14 (2A) of the Code. The scope of ‘essential goods and services’ was discussed in the report of the Insolvency Law Committee, 2018, which recorded as under:

“5.15 It was deliberated by the Committee that the ambit of the definition of “essential goods and services” in regulation 32 is limited to supplies which are essential for any corporate debtor, irrespective of the business it is carrying on.....”¹³

Therefore, the Insolvency Law Committee indicated that the determination of whether a supply constituted an essential supply or not could be made by way of examining if the supply would have been required for any corporate debtor, irrespective of the business run by it.

A similar formulation is also present in Discussion Paper on the Corporate Insolvency Resolution Process released by the IBBI on November 3, 2019 which states as under:

“9. The CIRP Regulations illustrate that water supplied to a CD is essential supplies for drinking and sanitation purposes, and not for generation of hydro-electricity. Thus, supply of water for generation of hydro-electricity is not essential supplies. It needs to be supplied in large quantities, though it not necessary for all CDs...”¹⁴

Therefore, the discussion paper also links the determination of essential supplies to supplies which are necessary in all CIRPs and required by all corporate debtors, irrespective of the business carried out by them. A slightly different formulation has been taken for laying out the scope of ‘essential supplies’ in the Report of the Insolvency Law Committee, 2020, wherein it has been noted that:

“The term ‘essential goods and services’ is defined in Regulation 32 of the CIRP Regulations to mean “electricity, water, telecommunication services and information technology services to the extent these are not a direct input to the output produced or supplied by the corporate debtor.” These are basic supplies that are necessary for “ensuring orderly completion of the proceedings”.”¹⁵

Therefore, the regulatory intent is to cover basic minimum supplies which are not specific to the business of a corporate debtor, rather are needs common to all corporate debtors, under the definition of ‘essential supplies’. Further, the intent behind the continuation of essential supplies, as highlighted

¹³ Report of Insolvency Law Committee, 2018, at para 5.15.

¹⁴ Discussion paper on the Corporate Insolvency Resolution Process dated November 3, 2019, at para. 9.

¹⁵ Report of Insolvency Law Committee, 2020, at para 8.13.

under the Insolvency Law Committee Report, 2020 is not to ensure that a corporate debtor continues functioning as a going concern, rather, it is to ensure orderly completion of the CIRP.

Judicial interpretations and confusions between ‘essential supplies’ and ‘critical supplies’

Owing to the different possibilities of interpreting ‘essential supplies’ and ‘critical supplies’, tribunals have been faced with instances wherein there is a difference of opinion between the resolution professional and supplier on the characterization of a supply as ‘essential’ or ‘critical’. In *Executive Engineer, Uttar Gujrat VIJ Company Ltd v. Devang P. Samapat, Kanoovi Foods Pvt. Ltd.*, 2021 SCC OnLine NCLAT 601, the NCLAT was faced with a situation wherein the supplier of electricity asserted that it was supplying a critical service, and accordingly, was required to be paid on a current basis. This was refuted by the resolution professional, who asserted that electricity being supplied to the corporate debtor was an essential supply. In this regard, the NCLAT noted the end-use of the electricity being supplied, which was not towards the manufacturing of biscuits, which was the business of the corporate debtor, but rather for the running of the office of the corporate debtor itself. Accordingly, the same was in the nature of an essential supply, and could accrue as CIRP cost.¹⁶

A similar approach was followed by the NCLAT in the case of *Harish Taneja, The Resolution Professional of Perfact Color Digital Prints Pvt. Ltd. v. Dakshin Haryana Bijli Vitran Nigam Vidyut Sadan*, 2021 SCC OnLine NCLAT 281, where electricity being supplied to the corporate debtor was being used to keep its printing machines in working condition, and such electricity was disconnected on grounds of non-payment. The corporate debtor here was involved in the printing business. Accordingly, the NCLAT held that the supply of electricity to power the printing machines was not an essential supply, in light of the Regulation 32 of the CIRP Regulations excluding any direct input to an output of the corporate debtor from the ambit of ‘essential supplies’. Therefore, payment for the same was required to be made under Section 14 (2A) to ensure continuance of supplies. However, liberty was given to the resolution professional to provide details of electricity supply required which would not constitute direct inputs to the output supplied by the corporate debtor, and the same could be resumed as essential supplies.¹⁷

While this approach seems to be in line with the regulatory intent of only covering such supplies which are not specific to the business of a corporate debtor, and the requirement whereof arises only in pursuance of the principal business activity of the corporate debtor, it is important to mention that certain confusing approaches have been taken by certain NCLTs. The NCLT, Amravati Bench in *Southern Power Distribution Company of Telangana Limited (TSSPDCL) v. Nizam Deccan Sugars Limited*, 2021 SCC OnLine NCLT 6378, for instance required the corporate debtor (then in liquidation) to make payment for electricity being supplied to the residential quarters of its employees.¹⁸ Technically, such electricity supply was not related to the business of the corporate debtor.

Interestingly, in *State Bank of India v. Rohit Ferro Tech*, 2020 SCC OnLine NCLT 15717, the NCLT, Kolkata Bench relied on interpretations of NCLAT in specific cases (passed prior to the introduction of Section 14 (2A) of the Code) ordering for payment on a current basis for essential supplies and held that:

¹⁶ *Executive Engineer, Uttar Gujrat VIJ Company Ltd v. Devang P. Samapat, Kanoovi Foods Pvt. Ltd.*, 2021 SCC OnLine NCLAT 601.

¹⁷ *Harish Taneja, The Resolution Professional of Perfact Color Digital Prints Pvt. Ltd. v. Dakshin Haryana Bijli Vitran Nigam Vidyut Sadan*, 2021 SCC OnLine NCLAT 281.

¹⁸ *Southern Power Distribution Company of Telangana Limited (TSSPDCL) v. Nizam Deccan Sugars Limited*, 2021 SCC OnLine NCLT 6378.

“10. The Explanation inserted below section 14(1) and the newly inserted subsection (2A) of section 14, which embodies the judicial interpretation of section 14 by the Hon'ble NCLAT in so far as it applies to payment for essential supplies during the period of moratorium.

11. Both of these insertions in the law make it absolutely clear that there are duties enjoined on the service provider to continue to supply the service during the period of moratorium. However, this is also coupled with a corresponding duty on the part of the corporate debtor to pay dues arising from such supply during the moratorium period. This is to ensure a level playing field to both sides. Any undue leniency or harshness, as the case may be, to one side will upset this equilibrium. The discoms cannot be expected to continue to supply electricity while even current dues are not being made by the corporate debtor.

12. While it is all very well to argue that the supply of electricity as a service essential to keep the corporate debtor as a going concern, it is equally necessary on the part of the corporate debtor, now in the hands of the resolution professional, to ensure that payments are made in a timely manner. We are not expected to show any undue favours to the corporate debtor just because it is in the hands of a resolution professional, nor do we desire to do so. Doing this may send a wrong message that the corporate debtor would somehow get protection from the Adjudicating Authority even in case of default in payment of the current dues in respect of the service provided, just to keep the corporate debtor afloat as a going concern. We cannot allow extension every time on one pretext or the other in making payment to the electricity supply company by the Applicant....’¹⁹

From the above, it is apparent that the NCLT extended the scope of payment protections provided under Section 14 (2A) of the Code to essential supplies relying on precedents passed much prior to the introduction of Section 14 (2A) of the Code. This judgment blurs the line between the effects of provisions relating to critical and essential supplies.

Therefore, the continuing overlap between essential and critical supplies could set the stage for further confusion as regards designation of a common set of supplies into two divergent categories. To prevent this, there is a necessity for some further guidance on clear demarcations between ‘essential’ and ‘critical’ supplies within the Code itself.

III. Concluding Remarks

The introduction of ‘critical supplies’ within the Code is a fairly new phenomenon, however, in isolation, it cannot operate to completely balance the interests of suppliers and corporate debtors within the insolvency framework in India. Further clarity shall be required on the designation of critical suppliers, as well as on the dynamic situations which may arise between corporate debtors and supplies during the course of the CIRP to fully achieve the purposes of the provision, and to create adequate protections for both the corporate debtor and critical suppliers in a CIRP.

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¹⁹ *State Bank of India v. Rohit Ferro Tech*, 2020 SCC OnLine NCLT 15717.

