

# Understanding the IBC

## KEY JURISPRUDENCE AND PRACTICAL CONSIDERATIONS

### CIRP Costs

Section 14 of the IBC prevents the payment of any pre-CIRP dues of a creditor during the moratorium period. The moratorium does not affect the payment of dues/costs arising in the course of the CIRP of the CD. These dues/costs are categorized as “insolvency resolution process costs” (CIRP costs), and to the extent unpaid, are to be given priority for payment under the resolution plan (section 30(2)(a)).

CIRP costs are defined in section 5(13) of the IBC to mean the following:

- **the amount of any interim finance and the costs incurred in raising such finance;**
- **the fees payable to any person acting as a resolution professional (this would include both the IRP and RP);**
- **any costs incurred by the resolution professional (IRP/RP) in running the business of the CD as a going concern;**
- **any costs incurred at the expense of the government to facilitate the insolvency resolution process; and**
- **any other costs as may be specified by the IBBI.**

As per regulation 31 of the CIRP Regulations, these costs mean the following:

- amounts due to suppliers of essential goods and services under regulation 32;
- the fee payable to the AR under regulation 16A(8);
- out-of-pocket expenses of the AR for discharging his functions under section 25A;
- amounts due to a person whose rights are prejudicially affected by the moratorium imposed under section 14(1)(d);
- expenses incurred on or by the IRP to the extent ratified under regulation 33

- expenses incurred on or by the RP fixed under regulation 34
- other costs directly relating to CIRP and approved by the CoC .

The Cost Circular issued by the IBBI explains these costs further and provides clarity on what can or cannot be included as CIRP Costs. Regulation 34 A of the CIRP Regulations provides that the IRP/RP shall disclose item wise CIRP Costs in such manner as may be required by the IBBI. The manner of the disclosure of these costs to IBBI is provided in the Cost Circular.

The fees/costs incurred by the RP are included as part of the CIRP costs. As per regulation 34 of the CIRP Regulations, it is the CoC that shall fix the expenses to be incurred on or by the RP and the expenses shall constitute CIRP costs. The expenses include the fee to be paid to the RP, the IPE, and professionals, and other expenses to be incurred by the RP.

Where the CD has cash flows or where interim finance has been raised, the CIRP costs can be paid during the CIRP as well. Since CIRP costs include costs incurred in running the business of the CD as a going concern, all regular course payments for liabilities arising during CIRP, such as payments to vendors for supply made during the CIRP or payment of wages and salaries to employees during CIRP period is paid out as CIRP costs during the CIRP. In case the CD does not have funds to make these payments, the resolution plan provides for payment of the same in priority to all creditors. It may be noted that the CIRP costs also get priority in payment (along with liquidation costs) in the distribution waterfall under section 53 (1) of the IBC, in case the CD goes into liquidation.

Hence, the CIRP cost can be met from the following resources:-

**1) Internal Resources;**

(i). Liquid funds available with the corporate debtor.

(ii) Disposal of unencumbered assets of CD, book value of which not to exceed 10% of the admitted claims, with the prior approval of CoC.

**2) External Resources ;**

Interim finance, either from CoC member or outside financier, with or without creating security interest over assets of the CD, with the prior approval of CoC.

Interim finance will form part of CIRP cost, which shall be repaid in priority during the liquidation process as per the provisions of section 52(8) & 53(1)(a).

In most of the cases of CD under insolvency, the CD is either facing negative cash flows or the operations are closed. It's very difficult to envisage a company under insolvency with positive cash flows. It's only companies with negative cash flows face difficulty in meeting their obligations and slip into insolvency.

As per the Code and regulations, IRP/RP is broadly responsible for the follow;

- Execution of Corporate Insolvency Resolution Process in accordance with the provisions of the Code & Regulations thereof.

- Manage the CD as a going concern, if it has not stopped operations prior to the date of commencement of insolvency.

In a fairly good number of cases, CoC is reluctant to approve interim finance. This puts the IRP/RP in a precarious situation, as he is responsible to carry out certain statutory duties under the Code besides managing the CD as a going concern

**In *Sunil Jain Vs. Punjab National Bank & Others [Company Appeal (AT) (Ins) No. 156/2018]***, the NCLAT held that if goods have been supplied during the CIRP period to keep the CD as a going concern, it is the duty of the RP to include the costs of such goods in the

insolvency resolution process cost. If it is not included, the resolution plan in question can be held to be in violation of section 30(2)(a) of the IBC.

**In *Edelweiss Asset Reconstruction Company Limited Vs. Sai Regency Power Corporation Pvt. Ltd. and Another, 2019 SCC Online NCLAT 921***, an appeal was filed by one of the unsecured FC challenging the decision of the AA in directing the appellant to pay their share towards interim finance by issuing a letter of comfort. The CD was engaged in the business of generation and sale of electricity. In order to generate electricity, the CD was procuring has from Oil and Natural Gas Corporation and GAIL India Limited. The gas supply agreement between the CD and GAIL was due to expire and therefore GAIL asked the CD to open/renew and submit a Standby Irrevocable Resolving Letter of Credit. The CoC passed a resolution to raise interim finance however certain creditors were reluctant to release the letter of comfort to the lead bank which was willing to disburse interim finance. The main plea taken by the appellant was that the CIRP costs which includes interim finance can only be recovered from secured creditors and not from unsecured FCs like appellant. The NCLAT held that when the CoC in a meeting of the FCs by requisite majority takes a decision with regard to CIRP costs, which includes execution of responsibility put by law on the IRP/RP to keep the company as a going concern, the same cannot be treated as forcing on the appellant to part with property or forcing to incur liability. If the appellant is a part of the CoC and wants to remain the part of the CoC, then the Appellant cannot expect to only claim benefits from the process and claim that it would not take any of the liabilities and responsibilities. In the meeting of the CoC, the appellant has the right to dissent but if the decision is still taken by majority provided under the statute, all the members of the CoC are duty bound to abide the decision.

## **CIRP COST CONTRIBUTION**

In the following cases, as in many other cases, CoC members were asked to contribute towards CIRP cost.

i). *NCLT Mumbai-I (31.10.2018) in Aqua Omega Services Pvt. Ltd. vs Great United Energy Pvt. Ltd. [MA 986/2018 IN CP (IB)-2104/MB/2018]* held that;. Therefore, as per the provisions of Regulation 33 and Regulation 34, it is the responsibility of the CoC to make the payment of Resolution professionals costs. In this case, CoC consists of sole Financial creditor, i.e. ICICI Bank. Therefore, ICICI Bank is directed to make the payment of the Resolution Professional cost along with IRP expenses, which has been ratified by the CoC before 5th November 2018.

ii). *NCLAT (10.01.2020) in Committee of Creditors M/s. Smartec Build Systems Pvt. Ltd. Vs B. Santosh Babu & Ors. [Company Appeal (AT) (Insolvency) No. 48 of 2020]* held that; we agree with the observations made by the Adjudicating Authority that the ‘Committee of Creditors’ is to pay the fees and cost incurred by ‘Interim Resolution Professional’, who also acted during the resolution process beyond 30 days till the date of liquidation having not allowed to continue as Liquidator.

iii) *NCLAT (10.12.2020) in Newgrowth Credit Pvt. Ltd.Vs.RP, Bhaskar Marine Services Pvt. Ltd. & Ors.[Company Appeal (AT) (Insolvency) No. 1053 of 2020]* held that; a CoC member is to bear his share of CIRP cost in proportion of his voting share and the period, he was a member of the CoC.

## **Supply of Critical Goods and Services during the Corporate Insolvency Resolution Process**

### **Introduction**

A key element of a modern corporate insolvency resolution processes is the provision of ‘breathing space’ to a debtor to enable assessment of its viability and sale of its assets or restructuring of its debts. In this period, therefore, the aim is to help businesses continue trading while a resolution that maximizes value for all creditors is reached. To enable this, it is key that critical suppliers, without the supply of whose goods and services the debtor cannot function, continue their supplies without interruption. Thus, for the orderly completion of the insolvency resolution process, insolvency laws may have some provisions that enable the continuation of the supply of such goods and

services. There is a need to examine how the continuation of such supplies is enabled under the Code.

### **Analysis**

Insolvency proceedings under the Code typically involve two kinds of critical supplies, (a) non-input ‘essential goods and services’ covered by section 14(2) and (b) other critical supplies. Supply of essential goods and services, as defined in the Regulations, is mandated under section 14(2) of the Code. Supply of critical supplies other than those covered under the definition of ‘essential goods

and services', is not mandated but has to be negotiated and secured by the resolution professional.

**(a) Essential goods and services covered by section 14(2)**

Section 14(2) of the Code states that when an order initiating the corporate insolvency resolution process is passed, the “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.” The term “essential goods and services” has been defined by the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 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. To illustrate, the Regulations specify that “water supplied to a corporate debtor will be essential supplies for drinking and sanitation purposes, and not for generation of hydro-electricity.” In other words, supplies constituting input for a finished product or services are not mandated. Thus, during the moratorium, section 14 of the Code (read with the Regulations) mandates the uninterrupted supply of only those specified goods and services which do not constitute a direct input for a finished product or service.

The Mumbai Bench of the NCLT in *ICICI Bank v. Innoventive Industries*, explained this position as follows “By reading this Regulation, it appears that electricity, water and telecommunication services and Information Technology service are to be considered as essential as long as these services are not a requirement to the output produced or supplied by the Corporate Debtor. Under this regulation, an illustration also been given saying that water is to be considered as essential service as long as it is used for drinking purpose and sanitization purpose but not for generating electricity. Whenever any illustration is given, it will be given to have an understanding about the provision of law. If supply

of water for drinking and sanitization purpose is an essential service, the supply of electricity is also deemed to be limited for lighting purpose and other domestic purposes, which are in modern days considered as essential service. If the same electricity is used as input for manufacturing purpose making huge bill of lakhs of rupees to get output from that industry, then to our understanding, supply of electricity is used as input for manufacturing purpose to get output from the factory and it obviously to make profits. Essential service is a service for survival of human kind, but not for making business and earn profits without making payment to the services used. When company is using it for making profit, then the company owes to make payment to the services/goods utilized in manufacturing purpose.”

NCLAT has specifically opined that “From subsection (2) of Section 14 of the 'I&B Code', it is also clear that essential goods or services, including electricity, water, telecommunication services and information technology services, if they are not a direct input to the output produced or supplied by the 'Corporate Debtor', cannot be terminated or suspended or interrupted during the 'Moratorium' period.”

Given that the supplies of such essential goods and services is mandated by the Code, the amounts due to such suppliers is given priority since these have been designated as insolvency resolution process costs, which are to be paid in priority to other debts of the corporate debtor. However, there was lack of clarity on whether payments need to be made for the supply of these goods and services during the moratorium period.

In *Innoventive Industries Ltd. v. Maharashtra State Electricity Distribution Company Ltd.*, the NCLAT passed an order requiring “the (Interim) Resolution Professional (IRP) to pay the charges due to respondent towards consumption of electricity since the date of moratorium...the IRP on behalf of the ‘Corporate Debtor’ will also pay month to month charges towards consumption of electricity failing which it will be open to the respondent – Maharashtra State Electricity

Distribution Company Limited to take appropriate steps.”

In *Dakshin Gujarat VIJ Company Limited v. ABG Shipyard Limited*, the NCLAT explained its reasoning for requiring payments for supply of essential goods and services during the moratorium period. They opined that “from the provisions of 'I&B Code' and Regulations, we find that no prohibition has been made or bar imposed towards payment of current charges of essential services. Such payment is not covered by the order of 'Moratorium'. Regulation 31 cannot override the substantive provisions of Section 14; therefore, if any cost is incurred towards supply of the essential services during the period of 'Moratorium', it may be accounted towards 'Insolvency Resolution Process Costs', but law does not stipulate that the suppliers of essential goods including, the electricity or water to be supplied free of cost, till completion of the period of 'Moratorium'. Payment if made towards essential goods to ensure that the Company remains on-going as made in the present case for the month of December, 2017, such amount can be accounted towards 'Insolvency Resolution Process Costs', but it does not mean that supply of essential goods such as electricity to be supplied free of cost and the 'Corporate Debtor' is not liable to pay the amount till the completion of the period of 'Moratorium'.” The NCLAT also noted that “if the 'Corporate Debtor' has no fund even to pay for supply of essential goods and services, in such case, the 'Resolution Professional' cannot keep the Company on-going just to put additional cost towards supply of electricity, water etc. In case the 'Corporate Debtor' (Company) is non-functional due to paucity of fund, and has become sick the question of keeping it on going does not arise”.

While the NCLAT has allowed payments to be made to suppliers during the process, it has not passed orders specifically allowing suppliers of essential goods and services to recover dues remaining unpaid prior to the commencement of the insolvency resolution process while the moratorium was in place. Instead they have held that it would be open for the supplier to submit a

claim for payment of their dues before the resolution professional.

### **(b) Other critical supplies**

In so far as critical supplies other than those defined as 'essential goods and services' are concerned, the supplies are to be procured by mutual agreement between the insolvency professional and the supplier, sometimes with approval of the committee of creditors. This is facilitated by the provisions of the Code which enable the functioning of the debtor as a going concern. Specifically, the Code requires that the interim resolution professional and resolution professional make every endeavour to run the corporate debtor as a going concern, and take all actions as are necessary to keep the corporate debtor as a going concern.

Like 'essential goods and services', the payment for other critical supplies will form part of cost of the insolvency resolution process and such suppliers have priority over other creditors under the resolution plan. However, despite this, some critical suppliers might be reluctant to supply during the insolvency resolution process.

## **Conclusion**

The Code enables the continuation of critical supplies to businesses during the insolvency resolution process. It enables the resolution professional to negotiate for the continuation of other critical supplies during the corporate resolution process and mandates the supply of the enumerated 'essential goods and services'. Payments for such supplies have priority of payment over other claims in the resolution plan. Further, the NCLAT has in many cases ordered that 'essential goods and services' be paid for during the insolvency resolution process.