

From Chairperson's Desk

Interim Finance – A Saviour

“The design of rules on interim financing requires a balancing act. The possible benefits of a successful reorganisation need to be weighed against the potential risks. The possible benefits are to be found in a potential successful reorganisation in which the going concern value is captured and liquidation is warded off. This potential upside needs to be balanced against the risks associated with interim financing”.

Role de Weijis and Meren Baltjes

When a firm enters insolvency, the Insolvency and Bankruptcy Code, 2016 (IBC / Code) and Rules and Regulations made thereunder enable the best effort to revive the firm in a time bound manner and protect its enterprise capital, thus maximising the value for the benefit of all the stakeholders. The going concern status of a firm improves prospects of its resolution and preserves the enterprise value of the firm. This principle was also recognised by the Bankruptcy Law Reforms Committee (BLRC), which stated that the objective of the Code with respect to value maximisation and resolution can be met by ensuring a business as a going concern under the insolvency process.

The Code aims to provide a fresh life to the failed businesses and the moratorium provisions accord a breathing space to the corporate debtor (CD) to focus on its operations and assess prospects of its reorganisation. To reiterate the going concern facilitations provided under the Code, an amendment was brought in December 2019 to clarify that a license, permit, registration, quota, concession, clearance or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law, shall not be suspended or terminated on the grounds of insolvency, subject to the payment of related dues during the moratorium period. A firm needs supply of inputs and capital to function. The Code reckons the supply inputs as the essential or critical goods/services and accordingly provides that these cannot be terminated or interrupted during the moratorium period. These provisions reemphasize that the CD needs to have a reasonable level of liquidity in hand to preserve its licenses and to ensure supply of critical inputs. The Code empowers the Insolvency Professional (IP) to raise interim finance as an endeavour to ensure the regular availability of funds during the resolution process.

The interim report of the BLRC suggested that if a financially distressed company is to successfully pull itself out of insolvency proceedings, continued operations during such proceedings is to be facilitated, for which the company would need access to external finance. However, once a company enters the insolvency proceedings, it would find it difficult to obtain credit as only a few lenders would be willing to lend to a troubled company. Therefore, the insolvency framework needs to encourage lenders to come forward to lend through various incentives such as giving super-priority to such interim finance, increased governance rights, safeguards for protection of creditor interests etc.¹

In line with the recommendations of the Committee, the Code provides for raising of interim finance during the insolvency resolution process with the approval of committee of creditors (CoC). Interim finance has been included in the 'insolvency resolution process costs' which is given priority in payment, over other debts of the CD, both in resolution plan and during settlement of debts in liquidation. The Code safeguards the interests of the creditors by providing that while raising interim finance, no security interest shall be created over any encumbered property of the CD, without the prior

consent of the creditors, whose debt is secured over such encumbered property.

Additionally, to encourage interim finance, on the recommendations of the Insolvency Law Committee (ILC)², the IBBI (Liquidation Process) Regulations, 2016 (Liquidation Regulations) were amended to include 'interest on interim finance for a period of twelve months or for the period from the liquidation commencement date till repayment of interim finance, whichever is lower' in the liquidation costs. The Insolvency and Bankruptcy Board of India (IBBI/Board) released a discussion paper (June 14, 2022) that reviewed the provisions of interim finance and suggested that the liquidation cost may include the interest on interim finance till the same is actually repaid. This move is aimed at facilitating and encouraging the CoC members to make adequate funding arrangements for running the CD as a going concern.

The Reserve Bank of India (RBI) also acknowledged the need of interim finance facilitated under the Code and provided for relaxation of provisioning norms for treatment of interim finance provided by the banking institutions. The Prudential Framework for Resolution of Stressed Assets issued in June 2019 provides that any interim finance extended by the lenders to debtors undergoing insolvency proceedings under the Code, may be treated as 'standard asset' during the corporate insolvency resolution process (CIRP).

For a distressed company, interim finance is not only a requisite to meet the insolvency resolution process costs, but to provide for regular payments made for availing critical input supplies. This assumes greater importance where the company hardly has any cash flows or deposits available but has operational capacity to generate revenue and stand on its feet. While in some cases, the CoC is opposed to lend finance to the distressed entity, in other cases, interim finance is given only to meet the process costs, which may not be adequate to sail the company through its reorganisation. Considering the level of uncertainty and risk, the lenders remain apprehensive of lending amounts to a company already under stress. A recent research study³ indicates that in around 85% of the cases, amounts less than ₹ 5 crore were raised as interim finance, which may suggest that the said funds were likely utilised to cover the process costs only.

However, as the Code matures, it is expected that there will be an increased awareness among the lenders about the benefits of raising interim finance during CIRP as a measure to attempt the resolution of the CD and saving it from going into liquidation. It is natural to expect that the existing lenders would be leading to provide the interim finance, as- (a) they are the beneficiaries to the higher chances of resolution and higher resolution amount being high in waterfall priority, so their interest in the outcome runs much deeper than an independent financier; and (b) they have much better access to the information about the business of the CD. Time and again, the judiciary has upheld the commercial wisdom of the CoC in deciding the fate of the insolvent CD. The Code looks upon CoC to set the highest level of standards in its conduct and performance to best assess the viability and feasibility of CD's business and facilitate revival of the CD.

(Ravi Mital)

¹Interim Report of the Bankruptcy Law Reforms Committee, February, 2015.

²Report of the Insolvency Law Committee, March, 2018.

³Iyer V.V. et al. (2022), "An analysis of interim finance ecosystem as a supporting tool for the IBC regime", Anusandhan: Exploring New Perspectives on Insolvency, p. 276.