INTERIM FINANCING BECOMES EFFECTIVE AND ATTRACTIVE

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Editor's Note: *Interim Finance is no less than an SOS when it comes to an insolvent company in corporate insolvency resolution process. In order to keep the entity as a going concern during the process or even maintain the entity as is, it is crucial to have a minimum liquidity – the situation becomes more critical when the company is already running into losses and has nil or depleting cash reserves. Interim finance provides for these emergency/urgent outflows. For this very reason, interim finance is accorded super-priority in payment waterfall across jurisdictions.*

However, for all commercial wisdom, the privilege of super-priority may not be sufficient for the interim financier to block its funds in an insolvent company, the fate of which lies uncertain. As such, the interim-financier has to be duly incentivised in terms of "return on investment", and "return of investment", so as to encourage interim-lending practices. As such, the Liquidation Regulations were amended to provide for interest on interim-finance post commencement of liquidation. The article discusses the amendment and its impact.

Interim financing, known by various names such as rescue financing, DIP financing, post-petition financing, etc., is a very important way for companies into resolution proceedings to financethemselvesforpressingfundingneeds,whetherforkeepingtheiroperationsgoingorfor the very effort of coming of distress. Globally, rescue financing is not merely the way for beleaguered companies to find their way to survival, it is also an attractive lendingopportunity.

With nearly 15 months of experience of resolutions in India, several companies in resolution have used interim financing; many lenders have also created lending desks for such funding. However, one of the biggest hurdles was the fact that there was no interest accrual once liquidation proceedings commence. This is the same for any lender - including a rescue lender. As a result, the interim financier faced the threat of losing interest for the number of months it would take to liquidate the assets of the company to do a take-out for the rescue financier. The amended Liquidation Regulations try to resolve the issue. This article discusses this new opportunity.

Interim finance means any financial debt raised by the resolution professional during the insolvency resolution process period

Introduction:

As per section 5(15) of the Insolvency and Bankruptcy Code, 2016 ("Code"), "interim finance" means any financial debt raised by the resolution professional during the insolvency resolution process period.

In simple words, as the name suggests, the term refers to the funds that the RP raises during the CIRP so as to retain the going concern nature of the entity and to carry out regular expenditure required for the same, until a resolution plan is approved by the CoC and subsequently by theNCLT.

Why is it needed?

As we know, while the CIRP is under process, the RP has to ensure the going concern status of the Corporate Debtor. While doing so, the RP has to make certain payments at any circumstances like payment to professionals appointed (valuers, RPs fees, etc.), payment to the workmen, payment to the security personnel etc, which are vital and cannot be kept on hold until the approval of the resolution plan. The cashflows of the entity may have dried up completely or may be insufficient to make such outlays. To make such payments, the RP surely requires funds and, at times, the company is not in a position to generate even the bare minimum amount required to cater the payments illustratedabove.

In such cases, the RP raises interim fund subject to the permission of the CoC.

What is the priority of repayment of interim fund?

As per section 53 read with section 5(13), "the amount of any interim finance and the costs incurred in raising such finance" being a part of insolvency resolution process cost takes the first priority under sec 53 (1) (a). This is true for both the repayment of principal as well as payment of interest on interim financing. Both of these qualify, along with other insolvency resolution and bankruptcy process costs for the first layer of payment to be made in the waterfall, in priority to any payments to any other stakeholders.

Why were the fund providers hesitant earlier?

Even though the status of interim funds is that of a "super priority loan" i.e. the loan that shall be repaid before all other loans that exists in the books of the company, lenders were hesitant to lend funds. This is because, as per the Code, the lenders were entitled to interest only for the period upto the order of liquidation of Corporate Debtor or completion of moratorium period (along with extension of 90 days), whichever is earlier. The interest would stop from the date of the liquidation order. Even though interim financing had its super-priority, but any priority has no meaning in absence of cashflows. If the entity slips into liquidation, the only way cashflows would occur is by disposal of assets, and the same may take time. During the time that lapses between order for liquidation and actual realisation of assets sufficient to pay off the interim financier, the financier would go dry. This made many lenders fear about loss of a huge sum of interest.

Liquidation Regulations amended to the extent to allow interest on interim finance for a maximum period of 12 months:

IBBI, vide Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2018 dated 28th March, 2018, has provided, that w.e.f 01.04.2018, liquidation cost includes 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 earlier.

This implies that interest on the interim finance till the date of order of liquidation shall form part of the CIRP cost, and the interest on the funds for a period of 12 months or period of liquidation (that is, period from liquidation order date till the actual realisation of the assets to pay off the financier), whichever is lower, shall now form a part of the liquidation cost. Thus, lenders will now be able to accrue interest for a maximum period of 1 year during liquidation. That is to say, lenders will need to sacrifice interest only if the liquidation proceedings take more than 1 year to realise the assets sufficient to pay off the interim financier.

It is important to understand that the liquidator, in liquidation proceedings, does not have to wait for disposal of all the assets before he starts settling the stakeholders as per sec. 53. Of course, the liquidator has to settle the list of stakeholders by filing the same with the adjudicating authority. Having done that, he may make interim distributions. Therefore, even if the assets are partly sold, the liquidator may pay off the whole or any part of the interim financing costs.

There are two interesting issues here – one, how does the interim financier file his claim at the time of commencement of liquidation, and two, how does liquidation process accommodate a variable amount of the claim, which increases as the interest accrues.

On the first issue, the interim lender may file claim to the extent of interim finance already outstanding as on the commencement of liquidation (since all claims are with reference to the liquidation commencement date). However, since the interest is a part of the liquidation costs, the same may be settled as a part of the costs of the liquidation process, in the same manner as other operating costs are paid – such as professionals' fees.

On the second issue – the cost of interim financing is a moving target – the amount obviously accrues and grows until it is fully settled. The liquidation process entails filing list of stakeholders and the amounts owed to them to the adjudicating authority, before starting any distribution. Any variation in the amounts of claims admitted may be done with the approval of the adjudicating authority. Once again, it may not be necessary to run for approval of the adjudicating authority for the accrued interest, because the same is a part of the liquidation cost.

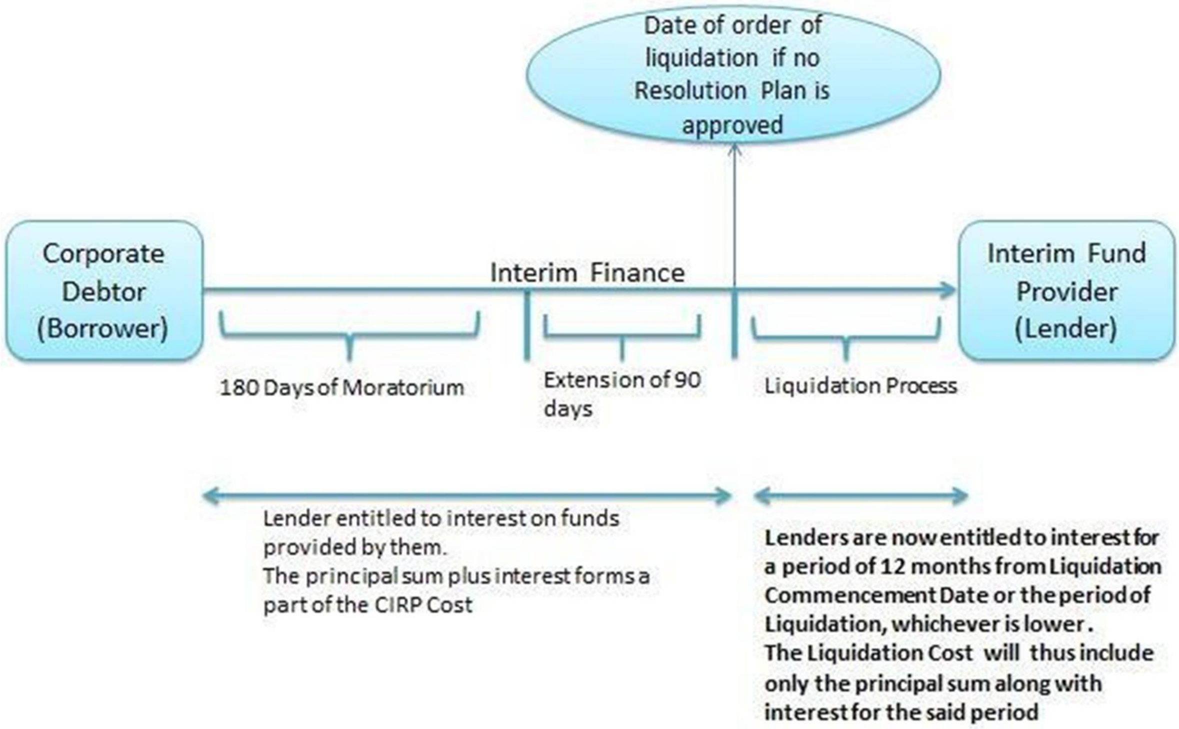

Figure 15: Timeline representing various stages of insolvency at which and its impact on Interim Financing

Effect of the Amendment:

One of the most critical aspects of rescuing companies under insolvency from the risk of liquidation is the availability of sufficient funds and the aforementioned amendment has made the availability of such funds easier. Lenders will now be more confident about lending funds to companies during the CIRP, which will make interim financing lucrative, and availability of such funds easier. This might also reduce the probability of the companies going intoliquidation.

Benefits to the Lenders:

1. **Higher InterestRate:**

   Interest rates on which funds are provided is higher than the market rate of loans, because the risk involved is comparatively higher. Also, while with the discussed amendment, interim funding becomes quite an interesting and lucrative market to explore, however, as a matter of fact, currently there are only handful of players and that also is one more reason for better interest rates from the point of view oflender.

   In our experience of interim financing, the rates quoted by lenders, and approved by committees of creditors, have been at least 500-600 bps higher than comparable lending rates to normal companies. This is a huge net interest margin for lenders.

2. **Priority Status of Loan:**

   The lenders enjoy a super priority status of loan i.e. their loan is repaid before any other loan existing in the books of the Corporate Debtor.

3. **Super securedloan**

   That the interim funds are repaid as superpriority (even before the workmen and the secured creditors), they are super secured. There is no security for interim financing as such – that is, no collateral rights over assets. However, since the super priority is statutory, there is no need for any security as such.

4. **Interest for a longerperiod:**

   The biggest advantage of the amendment has been that the lenders will now be entitled to interest even after commencement of liquidation and will enjoy the priority status during the liquidation process too.

Can a corporate debtor raise funds during liquidation?

The one word answer to the question is "No". There cannot be any borrowing done while the company is already under liquidation.

Conclusion:

The aforesaid amendment brought by the Board can completely change the current scenario of the Insolvency Process where the lenders will be voluntarily willing to provide interim funds to the Corporate Debtor. This might prove to be a big leap towards the achievement of aneffective and hindrance-free resolution process. Keeping in mind the benefits to the lenders, commensurate with the amendment, to lend interim funds can also be seen as a prospective profitable business bymany.

Stopping of accrual of the interest from the liquidation commencement date was the biggest demotivator for interim financing all this while; now that this hitch is removed, it seems that this will motivate more players to come in the market and do suchfunding.

The least this amendment will do is save a company from going into liquidation for mere scarcity of funds during CIRP.

Thus, it will not be an exaggeration to say that the Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2018 can prove to be a game changer in the CIRP process.
