**Debtors In Possession (DIP)**  **Financing / Interim Finance – some critical aspects**

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Ravindra Beleyur

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# Introduction

Many jurisdictions across the globe have been incorporating rescue / revival procedures to facilitate the organisations in distress to be taken over by management / investors who are capable of continuing the operations of the businesses as a ‘going concern’ before proceeding with declaration of liquidation / winding-up. There are jurisdictions where ‘going concern’ revivals are allowed / done through compromises and arrangements even when liquidation of the organisation has commenced based on court orders. Working capital is needed to run as a going concern, without which the organisation cannot be run as a ‘going concern’. Finance needed which needs to be raised for running it as a ‘going concern’ after insolvency / bankruptcy petition is filed in Debtors In Possession (**DIP**) regimes is called as DIP financing and it is called also as Interim Finance or Rescue Finance[[1]](#footnote-1). In some jurisdictions automatic stay starts as soon as such a petition is filed and in other jurisdictions, it starts only after the commencement of insolvency proceedings after an order for the same is pronounced by the concerned court. The phrase ‘Interim Finance’ is being used to the post-petition Finance in this paper irrespective of whether it is a ‘Debtor in Possession’ jurisdiction or a ‘Creditors in Possession’ jurisdiction.

The endeavour of this paper is to discuss some aspects about *access to post-petition / DIP financing is an essential component of any restructuring; analyse and compare the legislative provisions in two or more jurisdictions, including the ability to prime existing lenders and roll-up pre-petition debt into the DIP facility and also, comment on the market for DIP loans in the selected jurisdictions, terms, etc[[2]](#footnote-2)*., The objective is to briefly touch upon the importance / impact of Interim Finance, types of Interim Finance, perceived risks and actual risks for various stakeholders arising when a company in financial distress raises Interim Finance and then discuss the legislative provisions / some jurisprudence mainly of USA and Canada in more detail since Interim Finance space is more developed than in other jurisdictions and briefly touch upon the situation and some recent developments in some other jurisdictions and development of market for DIP loans in some of the jurisdictions including terms of such Interim Finance.

# Importance / Impact of Interim Finance

The origin, importance and priority given for the Interim Finance could be traced to the 19th century rail-road receiverships. The court while appointing the receivers for rail-road companies in distress used to authorise receivers to issue “receiver’s certificates’ which would have the first charge on the properties of the rail-road company[[3]](#footnote-3). Interim Finance is sought by an organisation essentially to preserve the value of an organisation, enhance the value of an organisation and as far as possible to make sure that the value of an organisation does not get eroded after the post-petition / commencement of the insolvency process after the pronouncement of a court order as the case may be depending on the specific jurisdiction. Research studies have shown that obtaining Interim Finance in Chapter 11 proceedings in USA have resulted in successful reorganisations, less time taken for the proceedings and reducing the costs of bankruptcy proceedings.[[4]](#footnote-4) The importance of Interim Finance cannot be undermined during the period of bankruptcy proceedings and as a result, many jurisdictions have given the priority of ‘administrative expenses’ and even ‘super-priority’ preference for repayment of Interim Finance along with interest when the organisation gets revived or even when liquidation happens in a worst case scenario.

# Types of Interim Finance

The types of Interim Finance which needs to be borrowed could be as follows[[5]](#footnote-5):

## ‘Super-priority’ or ‘Administrative expenses priority’

Continuation of credit by the existing suppliers when there is either ‘super-priority’ or ‘administrative expenses priority’ or continuation of working capital in the normal course of business presumably to keep the level of operations at the same level (which may only be possible if the working capital provider possibly with a floating charge has trust on the borrower or/and under a threat of losing more if the operations are stopped – many customers of the borrower may delay / avoid paying their dues when they become due if the operations get stopped suddenly) which existed as on the date of petition or on the date of commencement of bankruptcy proceedings depending on the law as the case may be.

## Other than for normal course of business

Getting unsecured Interim Finance for purposes for running the business other than for the purposes of normal course of business which may include running at a level of operations higher than what it was and for the purposes not covered as mentioned in the previous paragraph.

## Providing security of unencumbered assets

Getting Interim Finance taken on the security of unencumbered assets of the organisation. It is quite possible that there may be assets which have not been provided as security to the existing lenders. Security rights on such unencumbered assets could be provided to the lenders of such Interim Finance.

## Providing superior security right over the existing secured lenders

Getting Interim Finance taken based on providing a security right that is superior in ranking than an security right held by the existing pre-petition lender in the same asset. This may also include taking new borrowings from an existing pre-petition lender partly or fully to pay off the pre-petition debt. This is called priming or roll-up financing. This essentially hurts the interest of all other lenders since they may get much less than what they would have got otherwise either in a revival procedure or in a liquidation scenario.

# Risks perceived by Stakeholders:

In spite of such a priority given for the Interim Finance, there are risks perceived by many stakeholders regarding Interim Finance either from the existing lenders or from the new lenders. The risks[[6]](#footnote-6) perceived arises out of the possible opportunistic use of the situation by debtor as well as by the lender. Such risks could be listed as follows:

## Opportunistic use of the situation by debtor:

### Gain if the debtor revives and nothing to lose if it fails:

Running of the operations is normally done by the same management which existed as on the date of petition whether it is debtor in possession or creditors in possession regime, many times having some shareholding stakes in the debtor’s business. The shareholders and the management would benefit if there is a revival of debtor’s business whereas it is the creditors who would lose and bear the additional losses if the revival of the debtor’s business does not happen through the rescue / revival procedures.

### Possible diversion of the Interim Finance raised:

The possibility of taking Interim Finance for specific purposes and the likelihood of not using such funds for the purposes for which it was taken cannot be ruled out. The case in point could be utilisation of Interim Finance for the repayment of certain debts where the management / shareholders may have borrowed based on some personal guarantees and the availing of Interim Finance getting used for reducing such burden of the shareholders / management resulting in hampering the legal rights of secured creditors as well as the unsecured creditors in a wrongful manner.

## Opportunistic use of the situation by lender:

### The risk of cross-collaterisation:

This could normally happen when the Interim Finance provider was an unsecured creditor to the debtor and Interim Finance is provided by such unsecured creditor by seeking a security right on an asset against which no security right exists; it is quite possible that such Interim Finance provider puts a condition that part of the new secured loan be used for repayment of the earlier unsecured loans partly or fully. This could put many other creditors in a disadvantageous position either in a case where all creditors get less than what they would have otherwise got in a successful rescue situation or when rescue efforts fail and the debtor ends up in liquidation.

### The risk of seeking waivers by the secured creditors

In many cases, the existing lenders with security rights could pitch in to provide Interim Finance and possibly by putting waiver clauses regarding any repayment made to them during any look-back period to escape from the clutches of claw-back transactions.

### The risk of loan to own strategy

In some instances, the Interim Finance provider does not lend new money to the debtor in distress with an intention to get back interest and principal but, with an intention that they would get equity-swap for the amount lent. It is not that the debtor is oblivious to such an intention; but, the debtor takes such Interim Finance with an objective that the distress could be tide over and the loan could be paid back with interest presuming that the results on account of taking Interim Finance would be far better; if the anticipation with which the debtor has taken such Interim Finance does not materialise, such a strategy of the debtor could put all other creditors in a much more disadvantageous situation to the benefit of the loan to own Interim Finance provider. It is also not uncommon that existing shareholders provide Interim Finance to the debtor sometimes with a condition that shares be issued to them at a more advantageous terms than an outsider; but, if the court thinks such a plan submitted assumes the characteristics of a ‘sub rosa’ plan to the disadvantage of many pre-petition creditors, it would not approve such Interim Finance.

# DIP Financing USA

§ 364 of the Chapter 11 of US Bankruptcy Code discusses about the authority of a Trustee to raise Interim Finance or DIP financing in a Chapter 11 reorganisation bankruptcy proceedings. The relevant provisions as per the US Bankruptcy Code are enumerated in Annexure-1. The gist of the provisions are discussed as follows:

## No approval of court required

A trustee who is authorised to run business of a debtor as a going concern is entitled to obtain unsecured credit or incur unsecured debt in the ordinary course of business and such credit obtained / debt incurred gets the priority of an administrative expense. Obtaining unsecured credit or incurring unsecured debt in this way does not require any permission from any Bankruptcy Court as such. It could be presumed that nothing bars a trustee to obtain unsecured credit or incur debt for running at the level of operations which existed as on the date of filing the petition.

## With approval of court with administrative expense priority

In cases other than what is covered under the previous paragraph, a bankruptcy court may authorise a trustee to obtain unsecured credit or incur unsecured debt with the priority of an administrative expense, after notice and a hearing.

## With approval of court with administrative expense priority or with super priority of senior or junior lien on certain encumbered or unencumbered assets

 In case a trustee is not in a position to obtain any unsecured credit or incur unsecured debt based on priority of an administrative expense, a bankruptcy court may authorise such a trustee, after notice and a hearing, to obtain unsecured credit on a priority which is superior to all the administrative expenses or to any of the administrative expenses or obtain a credit or incur debt on the security/lien of any of the unencumbered asset until then or secured by a junior lien on property of the estate that is subject to a lien.

## With approval of court with super priority over existing encumbered assets

It may so happen that a trustee may not be in a position to obtain sufficient credit in any of the manner as discussed in the three previous paragraphs and it is only for the trustee to obtain Interim Finance only by senior lien or pari-pausu lien on an asset against which there already exists a lien. Even in this situation, a bankruptcy court after notice and a hearing, authorise such trustee to obtain credit or incur debt secured by a senior or equal lien on property of the estate that is subject to a lien only if it is satisfied that there is no other option for the trustee except this option and after ensuring that there is adequate protection for the original lien holder. The onus of proving that there is adequate protection for the earlier lienholder vests with the trustee. This essentially could include roll-up clauses and cross-collaterisation clauses which in the words of Stanford U in his Book - New Financing for Distressed Businesses in the Context of Business Restructuring Law could mean ‘*instructively the roll-up clause that entails the liquidation of pre-petition debt suggests a violation of US Bankruptcy policy as reflected in the provisions of the Bankruptcy Code’* and *‘as for the cross-collateralization clause, although it may not leave the other stakeholders with nothing, but it may deplete the assets of the estate of the debtor, leaving other creditors with less than they would have been entitled to but for the clause’.*

## Bankruptcy courts do approve Interim Finance in spite of risks and examples

It can be seen from the above, that a Bankruptcy Court necessarily has to accord approval for a trustee to raise Interim Finance in all situations other than getting unsecured credit or raising unsecured debt in the ordinary course of business. All the risks perceived by stakeholders exist in cases where a bankruptcy court has to accord its approval after notice and hearing. In spite of the existence of such risks, bankruptcy courts have approved Interim Finance even in big cases as can be seen in the following cases given just as a few examples[[7]](#footnote-7) are given in Table-1 -which involved roll-up, cross-collaterisation debt and even loan to own strategy:

## Table -1: Examples of DIP Finance approved by Bankruptcy Courts

| **Sl. No.** | **Case** | **Brief details of DIP facility granted** | **Remarks** |
| --- | --- | --- | --- |
| 1 | Avianca Holdings SA, 20-11133 (MG) (Bankr. SDNY 2020) | US$1.2 billion in new liquidity (Tranche A), along with a roll-up of about US$722 million of prepetition debt. (the Existing Notes Roll-Up) and US$386 million under a certain prepetition convertible secured loan facility provided to certain of the debtorsThe Tranche B agreement contemplates a minimum percentage of 72 per cent of the aggregate common equity if the company proceeds with the equity conversion. |  |
| 2 | LATAM Airlines Group SA, No. 20-11254 (JLG) (Bankr. SDNY 2020) | $2.45 billion DIPCredit Agreement provided by Oaktree Capital Management Inc and Tranche C loan is a $900 million first loss, undercollateralized junior loan by two largest shareholders of the Debtor. | Conversion of Tranche C Loan with 20% discount of the Plan value was not approved by the court since it was considered disadvantageous to many pre-petition creditors |
| 3 | Grupo Aeroméxico, SAB de CV, No. 20-11563 (SCC) (Bankr. SDNY 2020) | USD 1 Billion DIP financing by Apollo – an Investment firm | Court approved for conversion of this DIP Financing into 22.38% equity stake[[8]](#footnote-8) |
| 4 | Radioshack Corp, Case No. 15-10197, Docket No. 947 (Bankr. D. Del. March 12, 2015) | approving $285 MM DIP financing that rolls up $250.3 MM in prepetition debt |  |
| 5 | Constar Int'l Holdings LLC, Case No. 13-13281, Docket No. 212 (Bankr. D. Del.Jan. 16, 2014) | approving $17.4 Million DIP financing that rolls up $2.9 Million in prepetition debt |  |
| 6 | Constar Int'l Holdings LLC, Case No. 13-13281, Docket No. 212 (Bankr. D. Del. Jan. 16, 2014) | approving $17.4 Million DIP financing that rolls up $2.9 Million in prepetition debt |  |

## Common Issues raised by courts before approving Interim Finance - example

It needs to be appreciated that the extent to which a US Bankruptcy Court dwells into the objections of affected parties concerned while approving any Interim Finance for a Chapter 11 proceedings under Section 364. It can be seen from review of a judgement in respect of LATAM Airways in which the court raised following issues in thorough depth before giving its decision:

1. *Whether The DIP Financing Satisfies The “Entire Fairness” Test*
2. *Whether The DIP Facility, Including The Tranche C Loan, Resulted From A Fair Process*
3. *Whether The Debtors’ Review of the Jefferies Proposals Is Flawed*
4. *Whether The Debtors’ Admitted Failure To Market The Tranche C[[9]](#footnote-9) DIP Facility Pre-Petition Precludes A Finding That Its Process Was Entirely Fair*
5. *Whether The Independent Directors’ Review Of The Tranche C DIP Facility Complied With Chilean Law*
6. *Whether The Debtors Marketed The Tranche C DIP Facility Post-Petition*
7. *Whether the DIP Financing Facility Reflects a Fair Price*
8. *Whether the Tranche C DIP Facility Violates The Absolute Priority Rule*
9. *Though each of the DIP Lenders is entitled to a “good faith” finding under section 364(e), the Court considers whether the DIP Financing violates any applicable Bankruptcy Code principles*
10. *Whether the Tranche C DIP Facility Violates The Absolute Priority Rule*
11. *Whether the Tranche C DIP Facility Is an Improper Sub Rosa Plan*

The above queries/issues raised by the Bankruptcy Court are shared just to highlight the level of rigours at which the debtor has to prove the need for the Interim Finance with whatever conditions such Interim Financing needs to be agreed upon either with the existing or new lenders or with lenders with existing equity stake / future equity stake. In this case, though the Bankruptcy court approved the Interim Finance, it did not approve for the conversion of Interim Finance of Tranche C into equity with a more preferential treatment. It is of relevance to note that the court had got convinced about the absolute need of the Interim Finance needed before going into the issues mentioned above.

## Suggested basic rules of thumb

Kenneth Ayottef & David A. Skeel Jrff[[10]](#footnote-10) suggest *four basic rules of thumb to guide courts whether to focus more on liquidity or on respecting existing lenders' substantive rights.* Those four rules of thumb could be briefly mentioned as follows:

1. *the court should seek to determine why a debtor's existing lender is unwilling to make an additional loan before applying any of bankruptcy's liquidity-providing rules* – if existing lender does not intend to provide Interim Finance, it is a sign of the perception of the high risk involved.
2. *recognition that debt overhang is more serious in some contexts than in others* – if the benefits of additional liquidity results in more benefits to the existing lender with collateral security, it shows that Interim Finance serves its real purpose; in other cases, it may not serve the purpose.
3. *focus on the effects of information asymmetries –* a huge information asymmetry exists between existing lenders and a prospective lenders as such. Because of this , in case of very sudden bankruptcies, the courts may initially approve priming of existing loans for a short period of time and if new providers of Interim Finance do not show interest, it may indicate absence of going concern value and it may not be a fit case for revival and hence the approval of additional Interim Finance.
4. *the analysis also has implications for a court's decision whether to approve a proposed sale of assets to a third party –* if the existing owners and management are going to play an important role in the reorganised businesses when it is taken over by or sold to a new company, the court has additional inputs to take a call regarding approval of the additional Interim Finance.

In a nutshell, a bankruptcy court’s role has been to see that the risks in an Interim Finance as discussed earlier are addressed and the value for stakeholders who are not participating in providing Interim Finance in a post-petition situation does not get eroded and there is possibility of a fair treatment of such stakeholders in a revival or in a liquidation scenario.

# DIP Financing Canada

There are two related legislations regarding Bankruptcy and Insolvency in Canada. Bankruptcy and Insolvency Act (**BIA**) focuses on *the equitable distribution of the debtor’s assets among creditors[[11]](#footnote-11)* whereas Companies’ Creditors Arrangement Act (**CCAA**) is more or less similar to Chapter 11 proceedings of US Bankruptcy Code or possibly more similar to Compromises and Arrangements which are made under Companies Act of the United Kingdom where the main focus to see that the debtor continues its operations as a going concern through a revival process which gets approved at the end of the process in most of the cases. Interim Finance is accessed by debtors which undergo processes under BIA as well as CCAA with the approval of bankruptcy courts. Principles and practices remain similar in both the acts. So, the principles and practices under CCAA are discussed in this paper which have relevance even for cases which undergo process under BIA also, for the sake of keeping the concepts in simple terms. The relevant provisions related with Interim Finance as per the both the statutes are enumerated in Annexure-2 for an easy reference.

## Support of statute/s

Both the statutes on their own do not give any priority for the Interim Finance taken for running as a going concern unlike the case with US Bankruptcy Code even for securing unsecured Interim Finance for running the operations even in the ordinary course of business. In fact, a priority above the claims of Security Creditors is not given in the statutes even for expenses of the monitor (administrator), legal experts and professionals engaged by the monitor. Under Canadian Law, Interim Finance can be taken by a debtor on its application to a bankruptcy court, only based on a court’s order which can happen only after proper notice is given to Secured Creditors since their rights get affected when a higher priority is given for any Interim Finance taken by a debtor. However, after a recent amendment to CCAA in 2019, when a court admits an application under the Act, the Court declares stay for ten days and at the same time it can approve Interim Finance if that is a *relief that is reasonably necessary* to run the debtor as a going concern. Subsequent reliefs could be granted by a bankruptcy court regarding Interim Finance based on a specific application by a debtor /monitor after giving notice to Secured Creditors and after getting heard from such creditors.

## Considerations by court for approving Interim Finance

The court considers allowing priority for the Interim Finance over any existing security or charge after having regard to the following factors[[12]](#footnote-12):

(a) *the period during which the company is expected to be subject to proceedings under this Act;*

*(b) how the company’s business and financial affairs are to be managed during the proceedings;*

*(c) whether the company’s management has the confidence of its major creditors;*

*(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;*

*(e) the nature and value of the company’s property;*

*(f) whether any creditor would be materially prejudiced as a result of the security or charge; and*

*(g) the monitor’s report*

## Ratio / rationale by court to approve Interim Finance based on case law

The ratio or rationale given by Bankruptcy Courts to approve Interim Finance in U.S. Steel Canada Inc. (Re), 2016 ONSC 4838 (CanLII) and Lydian International Limited – judgement date –29th April, 2020 - Ontario Superior Court Of Justice could give an indication of what aspects are looked into by bankruptcy courts, while approving Interim Finance with a charge with higher priority than the Secured Creditors. The observations made in the latter case which talks about the US Steel case are reproduced which give more clarity for any reader:

*In U.S. Steel, the Court approved an agreement that extended the maturity of an existing DIP loan. In approving that agreement, the Court noted, amongst other things:*

*(a) the DIP loan provided an important cash buffer to meet any unforeseen working capital needs during the extended period;*

*(b) the DIP loan provided for stability and confidence to the bidders participating in the sales and investment solicitation process regarding the continuity of the business as it is currently operated;*

*(c) the DIP loan provided confidence to employees, customers and suppliers about the continuity of the debtor company’s operations; and*

*(d) there was no evidence of any material prejudice to any creditor of the debtor company if the amendment was approved and implemented.*

*……*

*Based on the following factors, the DIP Amendment should be approved and the increase to the DIP Facility should be secured by the DIP Charge:*

*(a) the current DIP Facility is set to mature on April 30, 2020. The DIP*

*Amendment will extend the maturity date to June 30, 2020, with milestones to be met in the interim;*

*(b) the increased DIP Facility will provide the Applicants with the required liquidity to maintain the Applicants’ business and allow the Applicants to continue focusing on restructuring transactions, including a potential sale;*

*(c) based on the Applicants’ cash-flow forecasts, the increased DIP Facility is sufficient to allow continued operations to and including June 30, 2020;*

*(d) the Monitor is supportive of the DIP Amendment;*

*(e) the DIP Amendment is not anticipated to give rise to any material financial prejudice; and*

*(f) the DIP Lenders are a subset of the Lydian Group’s senior secured creditors.*

It can be seen that the focus of the courts in Canada also had been to address the risks involved in Interim Finance as discussed earlier and to make sure priority status is given for such financing after making sure that there is an absolute need of the finance to run as a going concern such that the value of the debtor does not get eroded and it is just and equitable from the perspectives of all the stakeholders including that of the secured creditors.

# DIP Financing in some other jurisdictions – in brief

An effort is made to briefly touch upon the legal status of Interim Finance in other regimes like India, Germany, UK, Singapore, Australia and Mexico.

## India

It is of relevance to state that there was no comprehensive Insolvency and Bankruptcy statute which was being used on a regular basis until Insolvency and Bankruptcy Code, 2016(**IBC, 2016**) was promulgated effective from 1st December, 2016 which is applicable only for corporate entities as of now. The relevant provisions related with Interim Finance as per the both the statutes are enumerated in Annexure-3 for an easy reference.

### Support of Statute

IBC, 2016 of India defines Interim Finance as *any financial debt raised by the resolution professional during the insolvency resolution process period or by the corporate debtor during the pre-packaged insolvency resolution process period, as the case may be and such other debt as may be notified.* It is also of relevance that IBC, 2016 treats all the costs incurred to raise such Interim Finance, service the debt and the debt raised itself as Corporate Insolvency Resolution Process Costs – essentially administrative expenses in common parlance which needs to be paid on first priority before any other liability including that of secured creditors both in a revival / rescue process and in liquidation scenario. However, the Committee of Creditors consisting mainly of the Financial Creditors not related to the directors of the debtor whose claims have been admitted, need to approve the costs of Interim Finance and the debt itself with 66% voting percentage. No court approval is envisaged in the Insolvency Law as it stands now.

### A recent case law – similar to roll-up finance

In a recent case essentially a roll-up finance though not specifically considered as such and not paid with the priority of Resolution Process Cost in a Resolution Plan was challenged by the Interim Finance Provider (though not specifically classified as such) and the National Company Law Appellate Tribunal – an Appellate Bankruptcy Court declared such finance provided as ‘Resolution Process Cost’ and declared that Interim Finance provided connected with the matter to be paid in full in a Resolution Process[[13]](#footnote-13). The gist of the case is as follows:

Union Bank of India filed its claim for Non-funded Facility of Rs. 39.61 crores before the Resolution Professional of Amtek Auto Limited which was under the Corporate Insolvency Resolution Process under IBC, 2016. The Resolution Professional did not admit such claim under the pretext such liabilities had not crystallized on the date of claim. Whenever payments had to be made against the Letters of Credits opened under the Non-funded facility, such payments were made directly to the suppliers from the amounts received because of running the company as a going concern and the Resolution Professional continued to approach Union Bank of India to provided Non-funded facility further on a continuous basis – which essentially becomes an Interim Finance facility since these were very much required for running the company as a going concern and which also need to be considered as Corporate Resolution Process Costs. The total amount of payments done for such suppliers amounted to about Rs. 34 crores. Resolution Applicant did not provide for payment of Rs. 34 crores since the claims regarding the Non-funded Facility was not admitted and on the other hand the Resolution Applicant reduced Rs. 34 crores from the total amount payable to Union Bank of India since all the debits had gone out of the cash credit account of Union Bank of India though very much under the direct instructions of the Resolution Professional. The Appellate Tribunal essentially took a view that unless the payments were made to the suppliers for the Letters of Credits for the materials received from the suppliers during the Corporate Insolvency Resolution Process period, there would not have been sufficient limits for opening Letters of Credits under Non-funding limits and as a result, it would have affected running of the corporate debtor as a going concern; so, it considered the payments made presumably for the goods received during the Corporate Insolvency Resolution Process period as the Resolution Process Cost which needs to be paid in full on 1st priority by a Resolution Applicant in a revival situation or by the liquidator in a liquidation situation.

### Author’s own experience of Interim Finance

In India, lending has been predominantly by the Public Sector Banks. Most of the times, they do not hesitate to fund for the normal Resolution Process Costs or administrative costs in the common parlance of an insolvency situation in a situation where the operations of the debtor have been stopped. The issue arises when the operations of the debtor needs to be carried at a level which is resulting in incurring of cash losses mainly on account of the contribution from the level of operations not being sufficient to cover all fixed costs that are being incurred. This essentially means that such banks would get substantially less if the debtor ends up in a liquidation scenario. This is the reason why many existing lenders are unwilling to finance for continuing operations when the debtor continues to incur losses during the insolvency process period. It is also of relevance that if the operations are suddenly stopped, the debtor may not have enough funds to pay for the retrenchment compensation which may run to 6 months of wages in respect of certain category of employees and it should also be noted that once debtor’s operations are stopped and if the intention is to revive the debtor, it may take a quite a longer time for the new investor/management to re-start the operations and such costs may outweigh the losses due to running of operations at sub-optimal level. Author has a similar dilemma in one of his assignments recently. The debtor is a running hospital with 217 beds but operating at a very sub-optimal level of not even 10 to 15 beds when the Resolution Process started. This means that a continuous loss of about USD 30,000 to USD 35,000 per month and a continuous requirement of USD 35,000/- per month to cover up such cash losses. Author had to necessarily convince the Committee of Creditors about the necessity of running the hospital as a going concern to enhance the value of the debtor so that the new investor need not have to start from the scratch and the additional losses incurred during the resolution period would be worth in terms of all the stakeholders getting better value from the Resolution Plan of the new Investor. The existing lenders / Financial Creditors were unwilling to fund to cover the losses and the author in the capacity of the Resolution Professional of the hospital debtor had to raise Interim Finance to the tune of about USD 280,000/- though at a relatively higher cost than the funds borrowed earlier to cover the cash losses for about 7-8 months. This has helped in the New Investor giving a better value to all the stakeholders including to the existing shareholders in their Resolution Plan apart from their willingness pay for all the Resolution Process Costs including the Interim Finance raised with the related costs.

## Germany

In German Insolvency cases, the Labour office pays debtor’s payment obligation towards salaries for a period of three months during the period from the day petition for insolvency is filed and the formal initiation of the insolvency process. This essentially acts as Interim Finance as such. The preliminary administrators can seek permission from the court overseeing the insolvency case to obtain Interim Finance which would have to be repaid after formal commencement of insolvency proceedings. Normally, it is difficult to get any Interim Finance in such situation since there may not be any unencumbered collateral assets available for raising any Interim Finance without which it could be very hard to raise any Interim Finance. An administrator is empowered to raise Interim Finance after the formal commencement of the insolvency process to be paid out of the estate of the debtor. Administrators have a practice to get the approval of the Committee of Creditors for raising Interim Finance depending on the size and purpose of the Interim Finance. Lack of such approval does not make the loan agreement invalid or unenforceable. She/he need not have to seek approval of the court for the same. There is also a risk for the administrator that if any of such Interim Finance cannot be paid out of the estate of the debtor in a liquidation situation, such repayment of Interim Finance becomes personal liability of the administrator. *Recently, in some high profile cases, the German government has guaranteed a portion (usually 85%) of the loans that were obtained by administrators. The remaining risk would reside with the banks that extend the loan*.[[14]](#footnote-14) Recent Restructuring Update Act which is effective from 1st January, 2021 provides that the *New financing granted after the restructuring matter is legally pending are privileged under liability and avoidance law, to the extent that the knowledge of the pending restructuring matter or the use of the restructuring framework in itself does not establish liability or intent. This applies to new financing provided for in the plan as well as to interim and bridge financing[[15]](#footnote-15).*

## European Commission’s Recommendation

*The general philosophy of the EC’s recommendation on a new approach to business failure and insolvency is to facilitate new money financing with a view to promoting corporate restructuring and rescue This approach conforms very much to that taken in the UNCITRAL Legislative guide on Insolvency where the provisions on new money finance are said to have a threefold purpose. The first is to facilitate the flow of finance for the continued operation or survival of the debtor’s business or the preservation or enhancement of the value of the assets of the estate. The second is to ensure an appropriate protection for the providers of new finance, and the third is to ensure appropriate protection for those parties whose rights may be affected by the provision of such finance[[16]](#footnote-16)*. Article 17 of Directive (Eu) 2019/1023 Of The European Parliament And Of The Council of 20 June 2019 recommends member states regarding the Interim Finance as follows:

1. Members states need to ensure that – at a minimum – in the event of a future insolvency of the same debtor, providers of Interim Finance do not entangle with any kind of applicability of avoidance transactions as well as with any civil, administrative or criminal liability only on the reason of such Interim Finance being detrimental to the general body of creditors subject to certain exceptions.
2. Members states may provide priority in repayment of Interim Finance in subsequent insolvency proceedings in relation to other creditors who otherwise may have superior priority.

These recommendations are made with an intention to promote revival / rescue processes instead of the debtors ending up in winding up which is not good for the society in general.

# Cost of Interim Finance

Cost of Interim Finance tends to be quite high; it also varies according to the perception of risks related with the revival, purposes for which the same is utilised, the quantum of such finance needed for the debtor in distress, how the bankruptcy statute of the jurisdiction incentivises such finance including to what extent and with what priority the same is paid in liquidation scenario as well as more significantly on the interplay of demand and supply for such finance in the relevant market.

The interest rates can be as high as 12% p.a. which could go up to 19% p.a. when there is any default on repayment of such Interim Finance; there could be commitment charges of *0.5% to 3.0%[[17]](#footnote-17)* apart from administrative expenses including arrangement fees in the range of 0.5% to 1.5% of the amount of Interim Finance approved by the provider of such finance. Based on author’s experience, the cost of Interim Finance could be in the range of about 19%p.a. to 24% p.a. and it could be between 28% p.a. to 32% p.a. when there is any default of payment on repayment of such Interim Finance. The current prime lending rate of State Bank of India – a leading public sector bank is 12.20 p.a. Huge increase in the cost of Interim Finance is to do with perception of risk by providers of such finance as well as very limited providers of such finance in India.

Interim Finance can come in the form of Asset Based Lending also – which could be against the security of inventory, receivables and any other unencumbered assets which are part and parcel of running the debtor as a going concern or which are used for running the debtor as a going concern. In such cases, the interest cost could be much less than the Interim Finance obtained without the security of any asset base. It is also not uncommon that the existing lenders take this opportunity also to lend Interim Finance to pay off part of their pre-petition junior secured debts or unsecured debts when Interim Finance is not easily coming for certain debtors. This is called as roll-up facilities or priming. In case of Working capital facilities of Funded and Non-funded facilities (as seen in an Indian case law)and even in case of some critical suppliers, it may so happen that unless some of the pre-petition debts are paid, debtor would not be able to run as a going concern.

# Market for Interim Finance

A review of some of sample documents available on Summary Of Terms And Conditions Of The $ 8 billion for Lyondell Chemical Company[[18]](#footnote-18), Verasun Hankinson, Llc[[19]](#footnote-19) and similar other documents could give us an idea about how the market for DIP loans has matured in USA. It is not uncommon in USA for the existing lenders to provide Interim Finance in Chapter 11 revival proceedings though such Interim Finance more well known as DIP Financing does not come cheap and with any lenient conditions. USA being a debtor friendly regime where courts do allow roll-ups, cross-collaterisation and conversion of loan to equity through a court process, the market for Interim Finance is very well developed. This is not true in case of creditors in possession bankruptcy regimes like UK and Germany.

Many other markets which have not developed for Interim Finance may be connected to what Standford U succinctly states in his book - New Financing for Distressed Businesses in the Context of Business Restructuring Law by Sanford U about the New Finance which incudes Interim Finance in Frontier markets – ‘*Many frontier markets are characterized by their low liquidity, immature capital market[[20]](#footnote-20), as well as their low market capitalization[[21]](#footnote-21), and unpredictable restructuring regimes[[22]](#footnote-22)’.* It is also true that listing of commercial debts / papers has not developed in many such countries as it has developed in USA. The market for Interim Finance has not developed in countries where the lending is predominantly bank based system like in Germany and India. This also could be because of societal stigma attached to Insolvency per se. Interestingly, author understands that a major Public Sector Bank in India is deliberating on providing Interim Finance for debtors undergoing Insolvency process and develop it as one of their products in the market. It is quite possible that when some good big examples of real revivals happen which directly get reflected in contributing to the society – may be in terms of saving of jobs, inflows to the exchequer in terms of taxes etc., there is every possibility of better development of market for Interim Finance.

# Conclusion

There is substantial variation in how statute and jurisprudence treats Interim Finance provided to a debtor in distress during a revival process. It varies from quite a liberal approach provided under debtor-in-possession statute (though some approaches need a court’s approval to make sure it is not detrimental to the existing body of creditors), to the entire discretion given to the Committee of Creditors with the recommendation of an administrator like in Germany or India, or to purely left to the judicial power to grant approvals for such Interim Finance like in Canada or left purely to the contractual obligations agreed to between parties in compromises and arrangements like in United Kingdom. It is true that absence of Interim Finance which could be equated to a breathing finance for a debtor which is a going concern could erode the value of a debtor since it may have to end up stopping its operations all of a sudden leading to various unwarranted consequences like possible non-receipt of trade recoverable, depletion of value of inventory, equipments etc.,; but, at the same time it is also true that running as a going concern may not be a viable option in all cases and if running as a going concern is done even unviable situations using Interim Finance could result in erosion of value of the debtor and to a great disadvantage of the pre-petition creditors including the creditors with security rights since most of the repayment of Interim Finance and the high costs of such Interim Finance could reduce the amounts available for them in a most likely winding-up situation. There is no doubt statutes incentivising providers of Interim Finance with administrative or superior priority as well such transactions not getting attracted as avoidance transactions in a subsequent insolvency is welcome and desirable; but, providing of Interim Finance in all cases may not yield the best results. So, the need for protecting the interests of pre-petition creditors is very much essential to make sure that Interim Finance is taken by a debtor only when it can enhance value of the debtor or at least it does not erode the value of the debtor compared to the situation of Interim Finance being not at all available.

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# Annexures :

## Annexure-1- Relevant sections applicable for Debtor-in-possession (DIP) financing as per US Code for Bankruptcy – limited only to Chapter 11 cases

**11 U.S. Code § 364:**

1. *If the trustee is authorized to operate the business of the debtor under section 721, 1108, 1203, 1204, or 1304 of this title, unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title as an administrative expense.*
2. *The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title as an administrative expense.*
3. *If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt—*
4. *with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title;*
5. *secured by a lien on property of the estate that is not otherwise subject to a lien; or*
6. *secured by a junior lien on property of the estate that is subject to a lien.*
7.

*(1) The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if—*

*(A) the trustee is unable to obtain such credit otherwise; and (B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.*

*(2) In any hearing under this subsection, the trustee has the burden of proof on the issue of adequate protection.*

1. *The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.*
2. *Except with respect to an entity that is an underwriter as defined in section 1145(b) of this title, section 5 of the Securities Act of 1933, the Trust Indenture Act of 1939, and any State or local law requiring registration for offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in, a security does not apply to the offer or sale under this section of a security that is not an equity security.*

**11 U.S. Code § 721: Authorization to operate business – in Liquidation Scenario**

*The court may authorize the trustee to operate the business of the debtor for a limited period, if such operation is in the best interest of the estate and consistent with the orderly liquidation of the estate.*

**11 U.S. Code § 721: Authorization to operate business – Reorganisation Scenario**

*Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor’s business.*

**11 U.S. Code § 1204: Removal of debtor as debtor in possession**

*(a) On request of a party in interest, and*[*after notice and a hearing*](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=11-USC-798154776-556503790&term_occur=103&term_src=title:11:chapter:12:subchapter:I:section:1204)*, the court shall order that the debtor shall not be a debtor in possession for cause,*[*including*](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=11-USC-1496914075-556503788&term_occur=242&term_src=title:11:chapter:12:subchapter:I:section:1204)*fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the commencement of the case.*

*(b) On request of a party in interest, and*[*after notice and a hearing*](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=11-USC-798154776-556503790&term_occur=104&term_src=title:11:chapter:12:subchapter:I:section:1204)*, the court may reinstate the debtor in possession.*

**11 U.S. Code § 1304 - Debtor engaged in business**

1. *A debtor that is self-employed and incurs trade credit in the production of income from such employment is engaged in business.*
2. *Unless the court orders otherwise, a debtor engaged in business may operate the business of the debtor and, subject to any limitations on a trustee under sections 363(c) and 364 of this title and to such limitations or conditions as the court prescribes, shall have, exclusive of the trustee, the rights and powers of the trustee under such sections.*
3. *A debtor engaged in business shall perform the duties of the trustee specified in section 704(a)(8) of this title.*

**11 U.S. Code § 1304 - Debtor engaged in business**

*(a) The trustee shall—*

* 1. *collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;*
	2. *be accountable for all property received;*
	3. *ensure that the debtor shall perform his intention as specified in section 521(a)(2)(B) of this title;*
	4. *investigate the financial affairs of the debtor;*
	5. *if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;*
	6. *if advisable, oppose the discharge of the debtor;*
	7. *unless the court orders otherwise, furnish such information concerning the estate and the estate’s administration as is requested by a party in interest;*
	8. *if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires;*
	9. *make a final report and file a final account of the administration of the estate with the court and with the United States trustee;*
	10. *if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c);*
	11. *if, at the time of the commencement of the case, the debtor (or any entity designated by the debtor) served as the administrator (as defined in section 3 of the Employee Retirement Income SecurityAct of 1974) of an employee benefit plan, continue to perform the obligations required of the administrator; and*
	12. *use all reasonable and best efforts to transfer patients from a health care business that is in the process of being closed to an appropriate health care business that—*

*(A) is in the vicinity of the health care business that is closing;*

*(B) provides the patient with services that are substantially similar to those provided by the health care business that is in the process of being closed; and*

*(C) maintains a reasonable quality of care.*

*(b)*

1. *With respect to a debtor who is an individual in a case under this chapter—*

*(A) the United States trustee (or the bankruptcy administrator, if any) shall review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor’s case would be presumed to be an abuse under section 707(b); and*

*(B) not later than 7 days after receiving a statement under subparagraph (A), the court shall provide a copy of the statement to all creditors.*

1. *The United States trustee (or bankruptcy administrator, if any) shall, not later than 30 days after the date of filing a statement under paragraph (1), either file a motion to dismiss or convert under section 707(b) or file a statement setting forth the reasons the United States trustee (or the bankruptcy administrator, if any) does not consider such a motion to be appropriate, if the United States trustee (or the bankruptcy administrator, if any) determines that the debtor’s case should be presumed to be an abuse under section 707(b) and the product of the debtor’s current monthly income, multiplied by 12 is not less than—*

*(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner; or*

*(B) in the case of a debtor in a household of 2 or more individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals.*

*(c)*

1. *In a case described in subsection (a)(10) to which subsection (a)(10) applies, the trustee shall—*

*(A)*

* + 1. *provide written notice to the holder of the claim described in subsection (a)(10) of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social SecurityAct for the State in which such holder resides, for assistance in collecting child support during and after the case under this title;*
		2. *include in the notice provided under clause (i) the address and telephone number of such State child support enforcement agency; and*
		3. *include in the notice provided under clause (i) an explanation of the rights of such holder to payment of such claim under this chapter;*

*(B)*

1. *provide written notice to such State child support enforcement agency of such claim; and include in the notice provided under clause (i) the name, address, and telephone number of such holder; and*

*(C) at such time as the debtor is granted a discharge under section 727, provide written notice to such holder and to such State child support enforcement agency of—*

*(i) the granting of the discharge;*

*(ii) the last recent known address of the debtor;*

*(iii) the last recent known name and address of the debtor’s employer; and*

1. *the name of each creditor that holds a claim that—*

*(I) is not discharged under paragraph (2), (4), or (14A) of section 523(a); or was reaffirmed by the debtor under section 524(c).*

*(2)*

*(A) The holder of a claim described in subsection (a)(10) or the State child support enforcement agency of the State in which such holder resides may request from a creditor described in paragraph (1)(C)(iv) the last known address of the debtor.*

*(B) Notwithstanding any other provision of law, a creditor that makes a disclosure of a last known address of a debtor in connection with a request made under subparagraph (A) shall not be liable by reason of making such disclosure.*

**11 U.S. Code § 503 - Allowance of administrative expenses**

1. *An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.*
2. *After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—*

*(1)*

1. *the actual, necessary costs and expenses of preserving the estate including—*
	* 1. *wages, salaries, and commissions for services rendered after the commencement of the case; and*
		2. *wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered, if the court determines that payment of wages and benefits by reason of the operation of this clause will not substantially increase the probability of layoff or termination of current employees, or of nonpayment of domestic support obligations, during the case under this title;*

*(B) any tax—*

1. *incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507(a)(8) of this title; or*
2. *attributable to an excessive allowance of a tentative carryback adjustment that the estate received, whether the taxable year to which such adjustment relates ended before or after the commencement of the case;*

*(C) any fine, penalty, or reduction in credit relating to a tax of a kind specified in subparagraph (B) of this paragraph; and*

*(D) notwithstanding the requirements of subsection (a), a governmental unit shall not be required to file a request for the payment of an expense described in subparagraph (B) or (C), as a condition of its being an allowed administrative expense;*

*(2) compensation and reimbursement awarded under section 330(a) of this title;*

*(3) the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by—*

*(A) a creditor that files a petition under section 303 of this title;*

*(B) a creditor that recovers, after the court’s approval, for the benefit of the estate any property transferred or concealed by the debtor;*

*(C) a creditor in connection with the prosecution of a criminal offense relating to the case or to the business or property of the debtor;*

*(D) a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title;*

*(E) a custodian superseded under section 543 of this title, and compensation for the services of such custodian; or*

*(F) a member of a committee appointed under section 1102 of this title, if such expenses are incurred in the performance of the duties of such committee;*

*(4) reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under subparagraph (A), (B), (C), (D), or (E) of paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney or accountant;*

*(5) reasonable compensation for services rendered by an indenture trustee in making a substantial contribution in a case under chapter 9 or 11 of this title, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title;*

*(6) the fees and mileage payable under chapter 119 of title 28;*

*(7) with respect to a nonresidential real property lease previously assumed under section 365, and subsequently rejected, a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease shall be a claim under section 502(b)(6);*

*(8) the actual, necessary costs and expenses of closing a health care business incurred by a trustee or by a Federal agency (as defined in section 551(1) of title 5) or a department or agency of a State or political subdivision thereof, including any cost or expense incurred—*

* 1. *in disposing of patient records in accordance with section 351; or*
	2. *in connection with transferring patients from the health care business that is in the process of being closed to another health care business; and*

*(9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor’s business.*

*(c) Notwithstanding subsection (b), there shall neither be allowed, nor paid—*

*(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor’s business, absent a finding by the court based on evidence in the record that—*

*(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;*

*(B) the services provided by the person are essential to the survival of the business; and*

*(C) either—*

*(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or*

*(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;*

*(2) a severance payment to an insider of the debtor, unless—*

*(A) the payment is part of a program that is generally applicable to all full-time employees; and*

*(B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or*

*(3) other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.*

## Annexure -2 : Provisions of Canadian Legislation related with Interim Finance

### Extracted from Companies Creditors’ Arrangement Act

***Interim financing***

*11.2 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company’s property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made. 11.2 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company’s property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.*

***Priority — secured creditors***

*(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.*

***Priority — other orders***

*(3) The court may order that the security or charge rank in priority over any security or charge arising from a previous order made under subsection (1) only with the consent of the person in whose favour the previous order was made.*

***Factors to be considered***

*(4) In deciding whether to make an order, the court is to consider, among other things,*

*(a) the period during which the company is expected to be subject to proceedings under this Act;*

*(b) how the company’s business and financial affairs are to be managed during the proceedings;*

*(c) whether the company’s management has the confidence of its major creditors;*

*(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;*

*(e) the nature and value of the company’s property;*

*(f) whether any creditor would be materially prejudiced as a result of the security or charge; and*

*(g) the monitor’s report referred to in paragraph 23(1)(b), if any.*

***Additional factor — initial application***

*(5) When an application is made under subsection (1) at the same time as an initial application referred to in subsection 11.02(1) or during the period referred to in an order made under that subsection, no order shall be made under subsection (1) unless the court is also satisfied that the terms of the loan are limited to what is reasonably necessary for the continued operations of the debtor company in the ordinary course of business during that period.*

***Stays, etc. — initial application***

*11.02 (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 10 days,*

*(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the Bankruptcy and Insolvency Act or the Winding-up and Restructuring Act;*

*(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and*

*(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.*

***Stays, etc. — other than initial application***

*(2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,*

*(a) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);*

*(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and*

*(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.*

***Relief reasonably necessary***

*11.001 An order made under section 11 at the same time as an order made under subsection 11.02(1) or during the period referred to in an order made under that subsection with respect to an initial application shall be limited to relief that is reasonably necessary for the continued operations of the debtor company in the ordinary course of business during that period.*

***Court may order security or charge to cover certain costs***

*11.52 (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of*

*(a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor’s duties;*

*(b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and*

*(c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.*

***Priority***

*(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.*

### Extracted from Bankruptcy and Insolvency Act

***Order — interim financing***

* *50.6 (1) On application by a debtor in respect of whom a notice of intention was filed under section 50.4 or a proposal was filed under subsection 62(1) and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the debtor’s property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the debtor an amount approved by the court as being required by the debtor, having regard to the debtor’s cash-flow statement referred to in paragraph 50(6)(a) or 50.4(2)(a), as the case may be. The security or charge may not secure an obligation that exists before the order is made.*
* ***Individuals***

*(2) In the case of an individual,*

* + *(a) they may not make an application under subsection (1) unless they are carrying on a business; and*
	+ *(b) only property acquired for or used in relation to the business may be subject to a security or charge.*
* ***Priority***

*(3) The court may order that the security or charge rank in priority over the claim of any secured creditor of the debtor.*

* ***Priority — previous orders***

*(4) The court may order that the security or charge rank in priority over any security or charge arising from a previous order made under subsection (1) only with the consent of the person in whose favour the previous order was made.*

* ***Factors to be considered***

*(5) In deciding whether to make an order, the court is to consider, among other things,*

* + *(a) the period during which the debtor is expected to be subject to proceedings under this Act;*
	+ *(b) how the debtor’s business and financial affairs are to be managed during the proceedings;*
	+ *(c) whether the debtor’s management has the confidence of its major creditors;*
	+ *(d) whether the loan would enhance the prospects of a viable proposal being made in respect of the debtor;*
	+ *(e) the nature and value of the debtor’s property;*
	+ *(f) whether any creditor would be materially prejudiced as a result of the security or charge; and*
	+ *(g) the trustee’s report referred to in paragraph 50(6)(b) or 50.4(2)(b), as the case may be.*

## Annexure-3 : Extracts of provisions from related with Interim Finance Insolvency and Bankruptcy Code, 2016 and CIRP[[23]](#footnote-23) Regulations – India

Section 5 (15) of IBC, 2016 defines “interim finance” *as any financial debt raised by the resolution professional during the insolvency resolution process period 3[or by the corporate debtor during the prepackaged insolvency resolution process period, as the case may be and such other debt as may be notified.*

Section 5 (13) of IBC, 2016 defines “insolvency resolution process costs” as*:*

1. *the amount of any interim finance and the costs incurred in raising such finance;*
2. *the fees payable to any person acting as a resolution professional;*
3. *any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern;*
4. *any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and*
5. *any other costs as may be specified by the Board;*

Regulation 31 of CIRP Regulations defines “Insolvency resolution process costs” under Section 5(13)(e) as:

1. *amounts due to suppliers of essential goods and services under Regulation 32;*

*aa) fee payable to authorised representative under sub-regulation (8) of regulation 16A;*

*(ab) out of pocket expenses of authorized representative for discharge of his functions under section 25A;*

1. *amounts due to a person whose rights are prejudicially affected on account of the moratorium imposed under section 14(1)(d);*

Regulation 32 of CIRP Regulations defines the essential goods and services referred to in section 14(2) as

*(1) electricity;*

*(2) water;*

*(3) telecommunication services; and*

*(4) information technology services,*

*to the extent these are not a direct input to the output produced or supplied by the corporate debtor.*

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

Section 53 of IBC, 2016 provides the priority order in which distribution of assets in a liquidation scenario. -

(1) Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within 53. Distribution of assets. -

(1) Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period as may be specified, namely: -

(a) the insolvency resolution process costs and the liquidation costs paid in full;

(b) the following debts which shall rank equally between and among the following:

(i) workmen’s dues for the period of twenty-four months preceding the liquidation commencement date; and

(ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52;

(c) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;

(d) financial debts owed to unsecured creditors;

(e) the following dues shall rank equally between and among the following:

(i) any amount due to the Central Government and the State Government

including the amount to be received on account of the Consolidated Fund of India

and the Consolidated Fund of a State, if any, in respect of the whole or any part of

the period of two years preceding the liquidation commencement date;

(ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;

(f) any remaining debts and dues;

(g) preference shareholders, if any; and

(h) equity shareholders or partners, as the case may be.

(2) Any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under that sub-section shall be disregarded by the liquidator.

(3) The fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients under sub-section (1), and the proceeds to the relevant recipient shall be distributed after such deduction.

Explanation. – For the purpose of this section-

(i) it is hereby clarified that at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full; and

(ii) the term “workmen’s dues” shall have the same meaning as assigned to it in section 326 of the Companies Act, 2013 (18 of 2013).

1. Rescue Finance could be a very broad term which could include financing for the entire revival of the company; but, this phrase is used in this paper only for a limited meaning of a period between the post-petition and the point at which a Rescue Plan is approved by an appropriate court. [↑](#footnote-ref-1)
2. Details as per the topic given for the assignment [↑](#footnote-ref-2)
3. Chapter 1: The History and Statutory Basis of Debtor-in-Possession Financing published by American Bankruptcy Institute in 2012. The authors of this chapter refer a court order passed in 1877 – the case known as Wallace v. Loomis, 97 U.S. 146 (1877) – the case is reproduced on webpage:

 <https://supreme.justia.com/cases/federal/us/97/146/>*.* [↑](#footnote-ref-3)
4. ‘The Impact of Receiving Debtor-in- Possession Financing on the Probability of Successful Emergence and Time Spent Under Chapter 11 Bankruptcy’ - Fayez A. Elayan And Thomas O. Meyer, published in Journal of Busines Finance & Accounting, 28(7) & (8), Sept/Oct 2001, 0306-686X [↑](#footnote-ref-4)
5. Many aspects taken from: Opening the Door for the Opportunistic Use of Interim Financing: A Critical Assessment of the EU Draft Directive on Preventive Restructuring Frameworks, Rolef de Weijs and Meren Baltjes, International Insolvency Review published by INSOL International - Vol. 27: 223–254 (2018) [↑](#footnote-ref-5)
6. These perceived risks are taken from - Ibid - Rolef de Weijs and Meren Baltjes – since such risks are well captured in their paper [↑](#footnote-ref-6)
7. Recent Developments in DIP Financing for International and Domestic Debtors, Richard J Cooper, Lisa M Schweitzer, Jessica Metzger and Richard C Minott Cleary Gottlieb Steen & Hamilton, extracted from extract from the 2022 edition of Global Restructuring Review's the Americas Restructuring Review., [↑](#footnote-ref-7)
8. https://www.bloomberg.com/news/articles/2022-01-28/u-s-bankruptcy-court-approves-aeromexico-chapter-11-exit [↑](#footnote-ref-8)
9. From the existing equity stakeholders who also intended their Interim Finance provided needed to be converted into equity at a more preferential arrangement. [↑](#footnote-ref-9)
10. Bankruptcy Law as a Liquidity Provider, Kenneth Ayottef & David A. Skeel Jrff, The University of Chicago Law Review, Volume 80 Fall 2013 Number 4, page nos. 1557 - 1624 [↑](#footnote-ref-10)
11. Debtor in Possession Financing: The Jursidiction Of Canadian Courts to Grant Superpriority Financing in CCAA Applications, Janis Sarra, University of British Columbia, Dalhousie Law Journal, Volume 23 Issue 2 Article 3 – Pages 337-384 [↑](#footnote-ref-11)
12. Section 11.2(4) of CCAA [↑](#footnote-ref-12)
13. Union Bank of India vs. Mr Dinkar T. Venkatasubramanian Resolution Professional of Amtek Auto Limited and others - Company Appeal (AT) (Insolvency) No.729 of 2020 – pronounced by National Company Law Appellate Tribunal, New Delhi on 27th January, 2022 [↑](#footnote-ref-13)
14. Financial Reorganizations in An Illiquid Economy, Robert J. Rosenberg Latham & Watkins LLP, New York Martin Prager PLUTA Rechtsanwalts GmbH, Munich Siv Sandvik DLA Piper, Oslo Stephen Taylor AlixPartners, London Silvio Tersilla Gianni, Origoni, Grippo & Partners, Rome Lionel Zaclis Barretto Ferreira, Kujawski, Brancher & Goncalves, Sao Paulo – paper presented at INTERNATIONAL INSOLVENCY INSTITUTE’s

Tenth Annual International Insolvency Conference, Rome, Italy on June 7-8, 2010 [↑](#footnote-ref-14)
15. <https://www.noerr.com/en/newsroom/news/german-restructuring-and-insolvency-law-update> [↑](#footnote-ref-15)
16. Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States’ relevant provisions and practices Tender No. JUST/2014/JCOO/PR/CIVI/0075, Written by Gerard McCormack, Andrew Keay, Sarah Brown and Judith Dahlgreen, January 2016, page 133, European Commission

Directorate-General for Justice And Consumers Directorate A — Civil Justice, [↑](#footnote-ref-16)
17. Market Trends, Recent Deal Terms in Retail DIP Financing, Jordan Myers, Counsel, Aston & Bird LLP, Journal of Corporate Renewal – June, 2018 issue [↑](#footnote-ref-17)
18. <https://www.sec.gov/Archives/edgar/data/842635/000119312509002416/dex101.htm> [↑](#footnote-ref-18)
19. <https://www.sec.gov/Archives/edgar/data/1343202/000119312508239224/dex101.htm> [↑](#footnote-ref-19)
20. The “frontier market” classification of certain developing economies is a somewhat recent classification applicable to certain countries with certain features which include high economic growth rates, but with small and relatively illiquid stock markets. They represent developing countries with high rates of economic growth but small and relatively illiquid stock markets. These markets are often at an early stage of development and have attracted attention due to their diversification opportunities and growth potential. Frontier Market securities tend to be more thinly traded than their Developed and even Emerging Market counterparts. Currently, about 26 countries fall within this categorization. See the Financial Times Stock Exchange (FTSE) Russel (Sept 2014) [↑](#footnote-ref-20)
21. See FT, Definition of Frontier Market. Available at <http://lexicon.ft.com/Term?term=frontiermarkets> accessed 18 Aug 2015 (“a frontier market is considered to have lower market capitalization and less liquidity than many emerging markets.”). [↑](#footnote-ref-21)
22. This is a problem not just for frontier markets but also for many emerging markets. See Wielebinski (2017) (“The one single factor that presents the most difficult challenge in addressing workouts and insolvencies in emerging markets is the lack of predictability.”). [↑](#footnote-ref-22)
23. CIRP = Corporate Insolvency Resolution Process [↑](#footnote-ref-23)