

American Bankruptcy Institute

Recent Trends & Issues in DIP Financing: Debtor, Lender, & Committee Perspectives

Sponsored by ABI's Secured Credit Committee
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- Jeffrey R. Dutson, *King & Spalding LLP*
- Devon J. Eggert, *Beck, Chaet, Bamberger & Polsky, S.C.*
 - Maris J. Kandestin, *McDermott Will & Emery*
 - Jed Donaldson (Moderator), *LimNexus LLP*

Agenda

- Panelist Introductions
- Pre-filing considerations, alternatives
- Lender concerns
- First-day hearing
- Creditors' committee appointment
- Second-day hearing
- Questions for the panel



BORROWER ALTERNATIVES TO DIP FINANCING

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OVERVIEW: DIP ALTERNATIVES

- There are a variety of alternatives to post-petition DIP financing that chapter 11 debtors have recently employed to provide requisite liquidity throughout the bankruptcy, including:
 - **1) Use of cash collateral (*i.e.*, *CEC*, *NPC*)**
 - Debtors seek authority to use existing cash collateral
 - Orders often provide similar adequate protections to those in a DIP order
 - **2) Pre-petition loans (*i.e.*, *Bristow* and *PHI*)**
 - Debtors obtain pre-petition loans that are not restricted by the administrative burdens or payment of professional fees
 - **3) Equity offerings (*i.e.*, *Hertz*)**
 - Debtors seek to obtain financing from public markets
 - Cash raised is not subject to adequate protection or any other restrictions
 - Unproven as a viable DIP financing alternative

DIP ALTERNATIVES: CASH COLLATERAL

- One of the most common alternatives to DIP financing employed by chapter 11 debtors is the use of existing cash collateral.
 - Despite access to PPP loans throughout the COVID-19 pandemic, there does not appear to have been a cognizable uptick in recent debtors opting to finance their cases solely through cash collateral.
- Cash collateral orders offer similar adequate protection to lenders:
 - Liens and/or replacement liens on pre-petition collateral
 - Superpriority administrative expense claims
 - Releases re lender liability
 - Right to credit bid
 - Payment of fees and expenses
 - Case control mechanisms
 - Budget approval provisions and reporting requirements
 - Maintenance of liquidity levels
 - Disbursements within a percentage range of approved budget amounts
- Case examples
 - *PHI, Inc.*; *NPC Int'l*; *CEC Entm't*; *Mallinckrodt plc*; *Arena Energy*; *Intelsat S.A.*; *Bristow Grp.*

DIP ALTERNATIVES: PRE-PETITION LOANS (PHI)

- PHI, Inc. obtained a \$70 million pre-petition term loan from Blue Torch.
 - Secured by PHI's aircraft, related spare parts, and certain other non-working capital assets, as well as a lien on all working capital assets.
 - Underlying credit agreement contemplated that PHI would file for chapter 11 shortly after signing and loan proceeds would be used for working capital or liquidity requirements.
- Pre-petition loan provided higher net cash to the debtors than other DIP proposals, “especially considering the professional fees that would have been incurred by negotiating and complying with the DIP’s terms.”
 - Allowed PHI to avoid “the administrative burden of seeking court approval to use the DIP financing, which would have interfered with daily operations of the Debtors.”
- PHI sought court authority for use of \$30 million of cash collateral, incorporating certain adequate protections to the pre-petition lenders including:
 - Replacement liens, superpriority administrative expense claims, releases, and interest payments.

DIP ALTERNATIVES: PRE-PETITION LOANS (BRISTOW)

- Bristow Group Inc. obtained a \$75 million pre-petition term loans from an ad hoc group of holders of its senior secured notes.
 - Secured by junior lien on collateral securing the secured notes and first-priority liens on previously unencumbered assets, including aircraft and equity interests BGI's first-tier foreign subsidiaries.
 - Included "equity conversion option" structured to give the borrower the option to convert the loan into reorganized equity under certain conditions.
- Pre-petition loan offered the best economic terms and allowed the debtors to "go in to chapter 11 with an agreement for the use of cash collateral, and avoid the prospect of a first-day valuation dispute."
- Bristow debtors sought court authority for use of cash collateral, incorporating certain adequate protections to the pre-petition lenders including:
 - Superpriority claims, replacement liens, current payment of interest, payment of fees and expenses, current reporting and adherence to certain adequate protection milestones.

DIP ALTERNATIVES: EQUITY OFFERING (HERTZ)

- In a “first of its kind” attempt, Hertz filed an emergency motion on June 11, 2020, seeking to fund its chapter 11 cases through the issuance of public stock to the market.
 - Although the stock closed at \$0.56 the day after the chapter 11 petitions, speculative trading had driven the stock to a post-petition high of \$5.53 by June 8.
- On June 12, the Court approved Hertz’s motion on the grounds that the proposed issuance provided superior terms to any traditional DIP financing.
 - The Court’s order contained no restrictions on Hertz’s use of proceeds from the issuance.
 - Certain existing shareholders filed a limited objection seeking adequate protection for the dilution such issuance would have, but were overruled.
 - The Court noted that shareholders do not have any property interest in authorized but unissued stock held by a company.
- On June 15, Hertz commenced an offering for up to \$500 million in common stock.
 - The Prospectus Supplement to the offering noted that the reorganization may render the stock “worthless.”
 - The SEC contacted Hertz later that day, alerting the company to an intended review of the Prospectus Supplement.
- On June 17, Hertz disclosed receiving communications from the SEC and suspended the offering.
- On June 18, Hertz announced, without elaboration, that it was in the best interests of the company to terminate the offering.
- Although the details are murky, a debtor seeking to take advantage of market speculation to fund their case(s) may have similarly limited success.



RECENT TRENDS IN DIP FINANCING

DIP TRENDS: *SUB ROSA* PLANS (*LATAM*)

- A *sub rosa* plan is a transaction or settlement amongst creditors that amounts to a *de facto* plan of reorganization but is not subject to plan confirmation requirements or other creditor protections set forth in the Bankruptcy Code.
 - As illustrated recently by the contested DIP in *LatAm*, courts typically decline to authorize such transactions, particularly when they pre-date the underlying plan of reorganization because creditors are not offered the same opportunities to protect their rights.
- In *LatAm*, the Debtors sought a secured superpriority multi-draw \$2.45 billion term loan facility with three separate tranches (Tranche A-C).
 - The DIP Credit Agreement allowed the Debtors to elect for the Tranche C DIP Lenders to purchase equity in the reorganized Debtors at a specified discounted value, upon repayment of the DIP.

DIP TRENDS: *SUB ROSA* PLANS (*LATAM*)

- The Court denied the initial DIP in *LatAm*, concluding that the DIP facility's equity subscription election created improper *sub rosa* plan treatment of Tranche C DIP lenders and the debtors' equity holders.
 - Judge Garrity noted that the modified equity subscription election subverts the reorganization process and provides a discount to Tranche C lenders that was not market-tested or approved by the Court.
 - The Court also indicated that the Tranche C facility was an insider transaction that violated the absolute priority rule because the shareholders would receive stock solely because of their status as shareholders, without the benefit of market-testing.
- The Debtors filed a revised DIP, modifying the DIP Credit Agreement to remove the equity subscription election.
 - The Court approved the revised DIP, noting that the revisions resolved *sub rosa* plan concerns.

DIP TRENDS: COMPETING DIPS (*VALARIS*)

- Debtors faced with competing DIP proposals must exercise reasonable business judgment when determining which proposal best fits their needs, both during the bankruptcy and upon emergence.
- In *Valaris*, the Debtors were presented with two competing DIPs:
 - a 12-month \$500M term loan DIP financing proposal with no milestones from an Ad Hoc Noteholder Group; and
 - a revolving DIP proposal from prepetition bank lenders.
- According to the Debtors, the Noteholder DIP offered better liquidity and repayment options as well as a path to a potential RSA that would allow the Debtors to escape their prepetition debt.
 - The DIP would be repaid through proceeds of a \$500M rights offering for new first lien notes to be issued at emergence, fully backstopped by ad hoc group members.
 - Purchasers of new notes would receive over 30% of the reorganized Debtors' equity, with another 2.7% available to backstopping parties.
- The prepetition bank lenders objected, arguing:
 - that tying the Noteholder DIP to an RSA created an impermissible *sub rosa* plan; and
 - that the revolving DIP's lower interest rate, lower commitment fee, and absence of a minimum liquidity covenant constituted a superior proposal.
- The Court overruled the bank lenders' objection, finding that the Debtors had exercised reasonable business judgment in selecting the Noteholder DIP, particularly given that the Noteholder DIP provided additional liquidity and was more aligned with the Debtors' overall restructuring objectives.
 - The court also noted that although the DIP may have opened an avenue to equitizing the debt, it would still be an uphill battle.



MARIS KANDESTIN

Biography

Maris Kandestin focuses her practice on bankruptcy and restructuring, with an emphasis on debtor-side, complex Chapter 11 representations. In addition to representing companies in Chapter 11, she represents equity holders, secured lenders, and other creditors and parties in interest. Maris also represents foreign representatives in Chapter 15 proceedings and advises clients in connection with out-of-court restructurings. She represents clients in a variety of industries, including the healthcare, manufacturing, energy, airline, pharmaceutical, real estate, software and technology, gaming and retail industries.

Partner

Wilmington

Tel +1 302 485 3940

mkandestin@mwe.com



Formation of Ad Hoc Groups

- A group of lenders or noteholders holding a material portion of the borrower's/issuer's debt organized to protect their collective rights and pursue maximum recovery on their claims.
- Ad hoc groups of lenders have been playing an increasing role in complex restructurings.
- Formation of these groups can be the catalyst that precipitates A restructuring (among other things, it may accelerate the perceived distress of an issuer).
- At times, the formation can be driven by professionals.
- The presences of CLOs can add complexity because they may not have the flexibility to provide chapter 11 financing.

DIP Lender Perspective: Primary Concerns



- Rollup
 - Existing lenders will want to have as much of their pre-petition debt as possible rolled up into the DIP Facility.
- Collateral
 - Use DIP facility to obtain liens on unencumbered property
 - Avoidance Actions and Proceeds of Avoidance Actions
- Control
 - The DIP Lenders will want to use the DIP Credit Facility to ensure that the case proceeds on a reasonable time frame
- Economics
 - Budget
 - Interest
 - Fees
- Stipulations on the validity of pre-petition liens and claims

DIP Lender Perspective: Holdout Lenders



- At a first-day hearing, holdout lenders may challenge the DIP on one or more of the following grounds:
 - Necessity
 - Does the Borrower really need the financing?
 - Can the interim DIP Budget be reduced?
 - Economics
 - Are the economics (rollup, size, fees, interest) reasonable?
 - Fairness
 - Were all prepetition lenders afforded a chance to participate?
 - Control
 - Does the DIP facility steer the case toward an outcome that doesn't maximize value?

DIP Lender Perspective: Disputes with UCC



- The following are regularly points of contention between the UCC and the DIP Lender
 - Carve-out/budget for UCC professional fees
 - Scope of collateral securing the DIP (e.g. Avoidance Actions)
 - Case control and timing
 - Stipulations regarding pre-petition liens and claims (challenge period/standing)
 - Sufficient funding to “pay the freight” (i.e., administrative expense claims)
 - Waiver of claims under Section 506(c)



Priming v. Subordinated Liens

- Section 364(c)(3) – junior DIP Financing
- Section 364(d) – Priming (Senior) DIP Financing.
- Generally speaking, a priming facility is extraordinary.
- Requirements:
 - Unable to obtain on any other basis; and
 - Adequate Protection
- What constitutes adequate protection?
 - Must protect the existing lienholder from any diminution in value.
 - Equity cushion
 - Replacement lien on unencumbered property



Restaurant/Retail Issues

- Post-petition lease payments
 - Krystal
 - Craftworks
- Required payment of administrative expense claims
 - Rent
 - FLSA Collective Action Claims
 - Income taxes generated from 363 sales



Case Study: *In re Ascena Retail Group*

- Proposed DIP gave favored lenders fees equal to 110% of new money
- Minority lenders precluded from participation.
- Allegedly offensive and discriminatory terms:
 - Exclusion of minority lenders from New Money DIP Term Loans, which included 1.16 to 1.00 roll-up plus an allocation of 44.9% of the common stock of the reorganized debtor
 - Redemption premium of 11.23% of total loans (new money plus roll-up) plus \$7.5 million fee (termination premium).
- Minority lenders objected and requested three modifications:
 - Opportunity for each Prepetition Term Lender that signs the RSA to participate in its pro rata share of the DIP
 - Elimination of the \$7.5 million equity premium payable to the Backstop Lenders
 - Elimination of the \$7.5 million termination fee
- Parties reached a settlement to resolve these issues; minority lenders obtained increased DIP participation rights



Biographies: Jeff Dutson



Jeff Dutson

Partner
Corporate, Finance and
Investments

Atlanta: (404) 572-2803
jdutson@kslaw.com

Jeff Dutson is a partner in the Corporate, Finance and Investment practice in King & Spalding's Atlanta office. Jeff's practice focuses on complex restructuring and insolvency matters. He has represented debtors, secured lenders and other investors in a variety of Chapter 11 bankruptcy cases and large commercial workouts. Jeff frequently represents institutional senior-secured lenders in syndicated credit facilities, with particular experience in the restaurant, healthcare, energy, transportation, manufacturing, and media industries.

Jeff is a graduate of the University of Chicago where he earned his law degree, with honors. He obtained a bachelor's degree, with honors, from the University of Georgia. Prior to joining the firm, Jeff served as a law clerk for the Honorable E. Grady Jolly of the U.S. Court of Appeals for the Fifth Circuit.

- Selected as a "Rising Star" for Financial Restructuring in IFLR 1000's Financial & Corporate guide.
- Member of the American Bankruptcy Institute and the Turnaround Management Association.
- Published a variety of articles on restructuring and insolvency issues.
- A fellow of the American College of Investment Counsel and serves as the Southern Reporter for the College's Private Notes newsletter.
- Former Board Member for the Atlanta NextGen Turnaround Management Association.

Selected Restaurant Matters

- Represented Ignite Restaurant Group and its affiliates in their Chapter 11 bankruptcy cases, which included a sale of the companies (S.D.Tex.).
- Represented agent to syndicated bank group in successful workout of O'Charley's, Ninety Nine Restaurant and Pub, Village Inn and Bakers Square restaurant concepts.
- Represented senior secured lender in successful workout of southeastern franchise chain.

ABI Presentation DIP Lender Issues Committee Perspectives

Devon J. Eggert



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Committee Challenge Rights and Timing

- Governs Scope and Time Period for Committee Challenges
 - Lien Avoidance / Other Avoidance Actions
 - Lender Liability
 - Typically 30 – 90 Days
- Other Considerations
 - Stipulations Regarding Collateral Values / Oversecured Status
 - Process and Timing for Certain Challenges



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DIP Lender Releases

- Scope of Releases Should Be Scrutinized (Who and What)
- Releases Should Be Limited to DIP Loan Issues (*e.g.*, LATAM Airlines Group, S.A.)
- Released Parties Could Be Interpreted to Cover Unintended or Unknown Releasees



Avoidance Action Recoveries

- Avoidance Actions Should Be Preserved For Benefit of General Unsecured Creditors
- Liens on Avoidance Actions Typically Not Approved. What About Proceeds of Avoidance Actions?
 - *In re Cobalt International*, 17-36709 (Bankr. S.D. Tx.)
 - *Buncher Co. v. Official Comm. Of Unsecured Creditors of GenFarm Ltd. P'ship IV*, 229 F.3d 245, 250 (3d Cir. 2000) (recovery should be for all unsecured creditors)
- Superpriority Claims Recoverable from Avoidance Actions



DIP Lender and Sale Process / Plan

- General Overreaching in Interim Orders (*e.g., In re Hollander Sleep Products, LLC*, Case No. 19-11608 (Bankr. S.D. N.Y.))
- Tight Sale and Plan Timelines
 - *In re Ravn Air Group, Inc.*, Case No. 20-10755 (Bankr. D. Del.) (plan confirmation in 76 days)
 - *In re Juno USA, LP*, Case No. 19-12484 (Bankr. D. Del.) (plan confirmation in 120 days)
 - *In re Centric Brands*, Case No. 20-22637 (Bankr. S.D. N.Y.) (plan confirmation in 125 days)
- Default Provisions
 - Judgment or Order Adverse to DIP Lender
 - Administrative Claim Without DIP Lender Consent



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506(c) Waiver

- Section 506(c) allows DIP to recover from collateral the reasonable, necessary costs and expenses of preserving or disposing of the collateral
- Waiver of this section can be seen as a “windfall” to secured creditors. *See e.g., In re The Colad Group, Inc.*, 324 B.R. 208 (Bankr. W.D. N.Y. 2005)
- Waiver of this section in Final DIP Orders is common
- Courts possibly open to objections to this waiver. *See In re Ravn Air Group, Inc.*, Case No. 20-10755 (Bankr. D. Del.)



PPP Funds as DIP Loan?

- Paycheck Protection Program provides loans that can be used for payroll costs, mortgage interest payments, among other costs
- Small Business Administration views DIPs as high risk for misuse or failure to repay, and thus refuses to grant PPP funds to DIPs
- Courts are split on requests to prohibit SBA from refusing DIP's PPP loan application on basis of bankruptcy filing. *See e.g., Hidalgo County Emergency Service Found. V. Carranza*, Case No. 20-40368 (5th Cir.) (finding Bankruptcy Court exceeded its authority in issuing an injunction against the SBA)





Devon J. Eggert

Devon Eggert is a Shareholder in the Bankruptcy, Receivership and Insolvency Practice Group of Beck, Chaet, Bamberger & Polsky, S.C.

Devon has represented creditors' committees, debtors, and secured and unsecured creditors in chapter 11 proceedings and out-of-court restructurings across the United States and abroad. His practice covers all aspects of complex chapter 11 cases.

In addition to his substantial restructuring experience, Devon represents receivers, trustees and other parties in liquidation proceedings across the country. He also represents both trustees and defendants in preference, fraudulent conveyance and other complex bankruptcy litigation.

His industry experience includes manufacturing, healthcare, food service and processing, professional services, telecommunications, technology, printing and media, automotive and aviation, real estate and financial services, among others.



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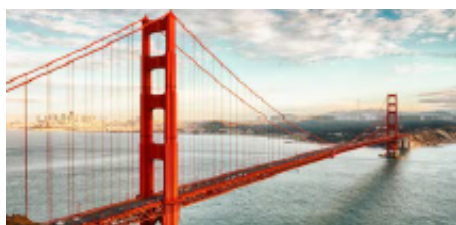


Telephone: (213) 955-9500
E-mail: info@LimNexus.com



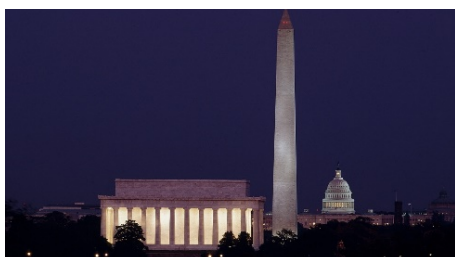
LOS ANGELES

1055 West 7th Street, 28th Floor
Los Angeles, CA 90017 USA



SAN FRANCISCO

220 Montgomery Street, Suite 1411, San
Francisco, CA 94104 USA



WASHINGTON DC

1050 Connecticut Ave, NW, Suite 500
Washington DC 20036 USA



Jed Donaldson, Esq. Of Counsel

Washington, D.C. / Richmond, VA
Jed.Donaldson@limnexus.com

Jed Donaldson concentrates his practice on insolvency-related litigation and distressed transactions. His practice covers bankruptcy and out-of-court workouts, in which he represents creditors, debtors, asset-purchasers, equipment lessors, trade vendors, committees, debtor-in-possession lenders, trustees, and debt buyers.

Recent Matters Include:

- *In re Ascena Retail Group, Inc., et al.* – counsel to trade vendors, including unsecured creditors' committee member
- *In re Chinos Holdings, Inc. (J. Crew), et al.* – counsel to trade vendor and unsecured creditors' committee member
- *In re Toys "R" Us, Inc., et al.* – co-counsel to agent and collateral trustee for TRU Taj noteholders in \$375 million DIP facility to debtors' Asian and European subsidiaries
- *In re Patriot Coal, et al.* - counsel to asset purchaser acquiring substantially all assets of coal companies via chapter 11 plan sale and post-confirmation litigation, including enforcement of plan injunction

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