AMERICAN BANKRUPTCY INSTITUTE

Annual Spring Meeting

CONCURRENT SESSION

What's Happening in DIP Financing?

Hon. Mary F. Walrath, Moderator
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2024

When Do DIP Protections Go Too Far?

- DIP lenders routinely get superpriority claims and adequate protection claims and liens for supplying "new value" to Chapter 11 debtors.
  - Debtors are permitted to exercise their business judgment with respect to the terms of that financing, including milestones and other case-control mechanisms.
- But there are limits:
  - A DIP cannot establish plan terms *sub rosa*: "A touchstone consideration in conducting that analysis is whether the proposed terms would prejudice the powers and rights that the Code confers for the benefit of all creditors and leverage the Chapter 11 process by granting the lender excessive control over the debtor or its assets as to unduly prejudice the rights of other parties in interest." *In re LATAM Airlines*, 620 B.R. 722, 816 (Bankr. S.D.N.Y. 2020).

When Do DIP Protections Go Too Far?

- Examples of *sub rosa* provisions in DIPs:
  - DIP Lender would receive controlling equity interest in Debtor. (*In re Belk Props., LLC*, 421 B.R. 221 (Bankr. N.D. Miss. 2009)).
  - Size of DIP loan was so large in relation to all estimates of value that it would wipe out any possibility of recovery for subordinate lienholders. (*In re Lafitte's Harbor Dev't*, 2018 WL 272781 (Bankr. S.D. Tex. 2018)).
  - DIP loan able to be repaid in new equity issued at a 20% discount to plan value, without a market test. (*In re LATAM Airlines*).
  - Plan must be approved by DIP Lenders, or an Event of Default will be triggered. (*In re LATAM Airlines*; *In re Belk Props., LLC*).

The Game Of Chicken: What Will Courts Approve?

- Examples of terms initially demanded by DIP lenders (unusual→generic)
  - No challenge period. (*WeWork*).
  - Event of default if any party files a motion seeking to challenge prepetition liens or takes any action adverse to pre-petition lenders (*NanoString*).
  - 2-to-1 roll-up (*NanoString*).
  - Consent over plan terms or event of default if plan does not repay DIP Lenders' pre-petition debt in full in cash (*Revlon*, *Nanostring*).
  - Liens on proceeds of avoidance actions--against DIP Lenders (*Revlon*).
  - Anti-marshalling provisions (and waivers of Section 506(c) and 552(b) protections).
    - in *NanoString*, express requirement to use asset sale proceeds to first pay prepetition debt of DIP Lenders.
  - Exit financing/backstop rights at discount to plan value.
  - Challenge periods too short, budgets too small for a real investigation.
  - Case milestones too short to meaningfully permit competing bids.
- **Has there been a paradigm shift caused by aggressive lender demands?**

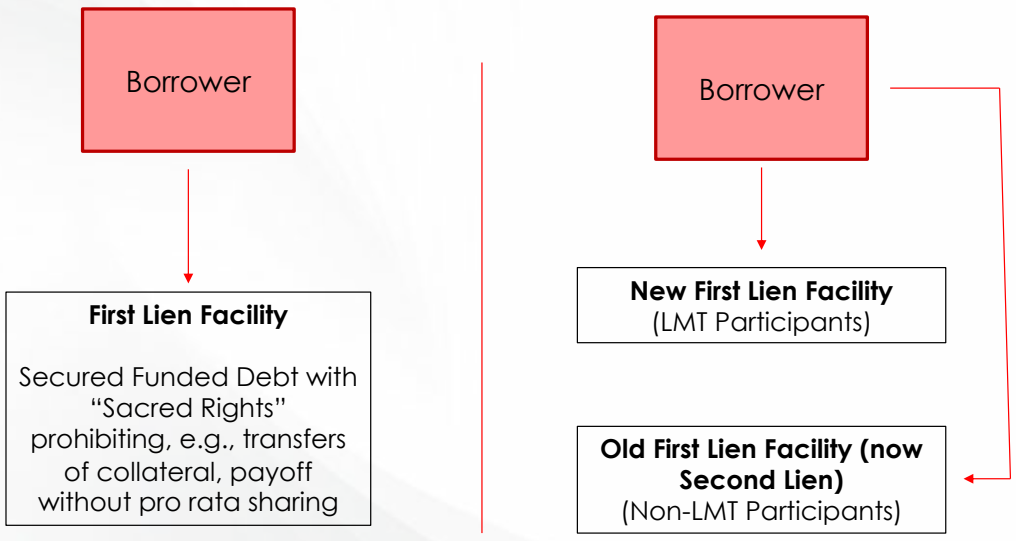
DIP Financing as "Step 2" of Liability Management

- Step 1: Liability Management Transaction
- Step 2: DIP Financing from favored LMT participants
  - Frequently including stringent case-control provisions, ensures protection from LMT challenges.
- Step 3: Case-exit strategy devised by favored LMT participants
  - Can be exit financing, equity, funded backstop, or any combination.

Step 1: What Is a Liability Management Transaction?

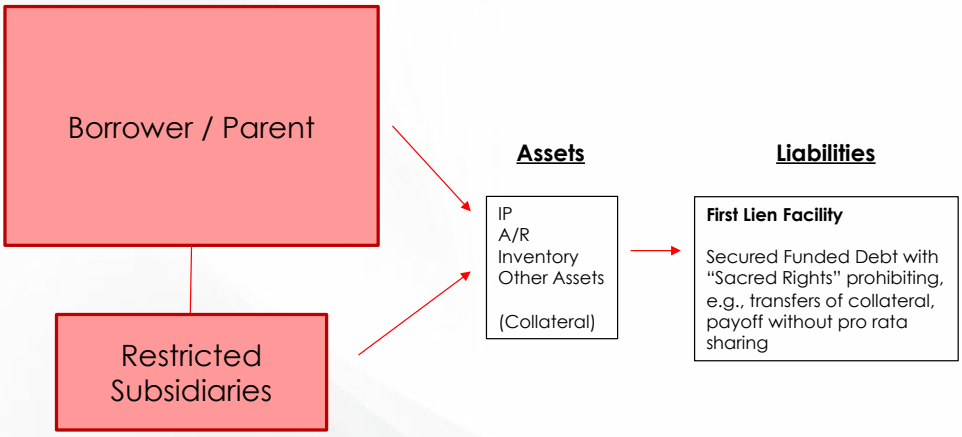
- A "liability management transaction" (LMT) is a transaction in which certain lenders modify the terms of an existing loan or indenture to permit the company to issue new secured debt to favored parties funded through new money, exchanges/rollups of old debt, or a combination of the two, effectively subordinating non-participating lenders.
- "Uptier Exchange": Majority lenders exchange their debt on a non-pro-rata basis for new senior secured debt.
- "Drop-Down" Transaction (The "J.Crew"): Company creates new unrestricted subsidiaries; majority lenders consent to amending contract to permit "drop-down" of prime collateral to new subs; majority lenders then roll up old debt into new loan to new subs as borrowers, secured by prime collateral.
  - In "covenant-lite" loans, there may be space for these transactions under the terms of the existing document.
  - But these transactions may (and often do) trigger litigation by non-participating lenders for violation of "sacred rights."

Uptier: Before and After



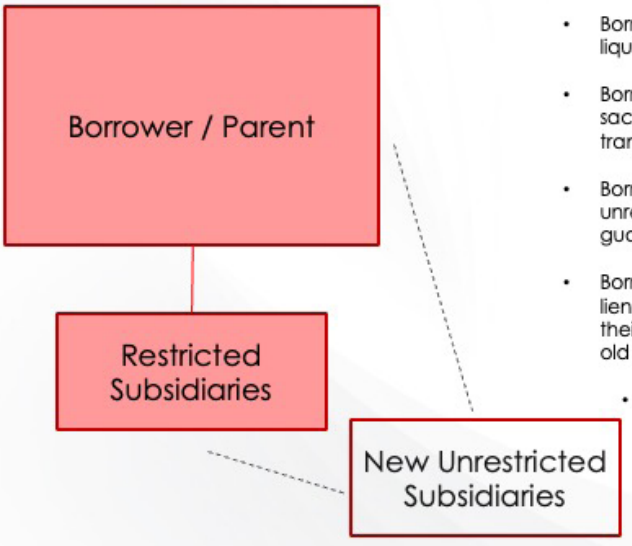
As part of the transaction, majority lenders may amend documents to change open-market provisions, strip covenants, permit issuance of new superpriority tranches, subordinate existing loans, reduce principal amount of existing loans (to permit roll-ups).

Drop-Down: The Borrower "Before"



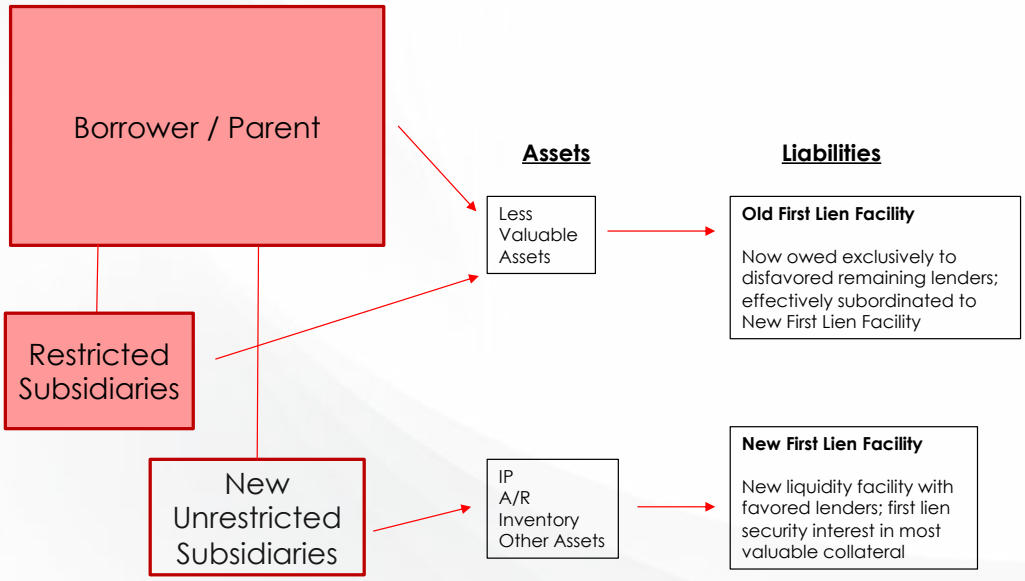
Restricted subsidiaries: entities required to comply with loan covenants, guaranty the loan and pledge collateral, and together with the parent borrower, restricted from certain investments and debt transactions. A borrower may also have unrestricted subsidiaries (e.g., foreign subsidiaries or defunct entities).

Drop-Down: The Transaction



- Borrower engages majority of lenders for liquidity transaction
- Borrower and favored lenders amend "non-sacred" loan provisions to permit limited transfers to unrestricted subsidiaries
- Borrower transfers collateral assets to unrestricted subsidiaries (that are not guarantors of existing debt)
- Borrower and favored lenders execute new first lien facility to borrow against new subs and their assets; roll up favored lender holdings in old first lien facility into new facility
  - Borrower may need to call the roll-up an "open market" transaction to evade sacred pro rata sharing obligations

Drop-Down: The Borrower "After"



Step 2: LMT Facility Becomes DIP

- Intercreditor Litigation is Stayed.
  - Debtor now (in the first instance) has standing to bring fraudulent transfer litigation.
- Liens on favored assets are "hardened."
  - Challenge period and budget governed by DIP terms.
- Adequate Protection liens are granted.
  - Frequently include liens on proceeds of avoidance actions—maybe even actions against DIP Lenders.
- DIP Lenders have important case controls.
  - Consent to venue.
  - Milestones.
  - Consent to plan (including exit provisions/financing).

Step 3: Exit

- Cash is not king for LMT/DIP Lenders.
- DIP Facility generally provides the architecture of the exit deal:
  - Equity? Warrants? Takeback paper? Backstop rights? Some combination?
  - Do the math: does the type/amount of that currency over-compensate DIP Lenders, given a particular valuation? Complicated structures can mask unexpected recovery rates.
- Sets the stage for a valuation trial at confirmation. Very expensive on all sides, allows for further settlement discussions.

Case Study: Revlon

- 2019 and 2020: Revlon conducts two separate "drop-down" transactions transferring valuable IP to new "BrandCo" subsidiaries. These BrandCos issue new debt to certain Revlon term loan lenders, rolling up their existing debt to the parent.
- August 2020: "Objecting" lenders sue. Litigation is complicated by Citibank's accidental payment in full to lenders.
- June 15, 2022: Revlon files for Chapter 11, with BrandCo Lenders as DIP Lenders.
- June 24, 2022: UST appoints Committee.
- July/Aug 2022: DIP trial

Case Study: Revlon

- Certain Proposed DIP Terms:
  - "Acceptable Plan": requires consent of DIP Lenders or repayment in full in cash of *pre-petition* BrandCo debt.
  - Adequate Protection Liens: Include liens on proceeds of avoidance actions and all other actions *against BrandCo Lenders*.
  - Marshalling waivers allow DIP lenders to look to these proceeds first, and to look to assets of parent and other operating subs where their pre-petition liens are shared, rather than having to look first to BrandCo assets where they have exclusive pre-petition liens.

Case Study: Revlon

- Certain Proposed DIP Terms (cont.):
  - Challenge: 75-day challenge period (tolls upon filing of standing motion); total budget of $50,000.
  - Milestones: Require Company to enter RSA/file Plan before holiday revenue is known, during company's busiest and most important period.
- UCC raised objections to each, including arguments that the DIP is effectively a *sub rosa* plan.

Case Study: Revlon

- DIP Trial: Two-day evidentiary trial.
- Court "signaled" from the bench that he would approve DIP; indicated some discomfort with certain provisions; encouraged parties to keep negotiating.
- Final DIP Order entered with key concessions that framed the rest of the case:
  - Challenge period extended from 75 days to 90 days.
  - Budget increased from $50k to $350k, with clarification that excess can be admin claims.
  - Two-week extension for RSA/Plan.
  - Preserved court's ability to modify provisions of Final DIP Order relating to adequate protection (based on outcome of challenge).
- End of case: BrandCo Lenders received vast majority of equity in reorganized company and take-back loans equal to their pre-petition claims. "Objecting lenders" got minority equity interests. Unsecured creditors received $44 million in cash.

Non-Pro Rata Roll-Up: Another LMT Strategy?

- *Sungard AS New Holdings, LLC, et al.* (No. 22-90018; S.D. Texas)
  - Prepetition capital stack included an ABL facility, a 1L term facility and two 2L term facilities (that as between them shared collateral on a *pari passu* basis).
  - Court approved DIP financing that, *inter alia*, permitted only the 1L prepetition lenders to roll up their respective prepetition term loans on a 1:2 ratio of new money financing to roll-up loans.
  - Any DIP lender that did not achieve the 1:2 ratio based solely on rolling up its 1L term loan position could also roll-up its 2L term loan position to achieve such ratio.
  - 2L prepetition lenders that did not also hold any 1L prepetition term loans excluded from the DIP financing (and the roll-up feature).
  - DIP financing ultimately not contested by the 2L term loan lenders that did not hold 1L term loans, but what if it had been?

Non-Pro Rata Roll-Up: Another LMT Strategy?

- Possible Arguments Against Non-Pro Rata Roll Up in *Sungard*
  - Neither reasonable nor necessary to the DIP facility.
  - Unreasonably and unnecessarily shifts costs related to the DIP facility from the Debtors' estates to the excluded 2L Lenders.
  - Violates the provisions of the prepetition *pari passu* intercreditor agreement (as between the two 2L term loan facilities).
  - Violates the sharing of payments provision within each prepetition 2L term loan credit agreement.
  - Violates 11 U.S.C. § 1123(a)(4) by adjusting priorities within a class of similarly situated creditors, specifically the prepetition 2L lenders.

Non-Pro Rata Roll-Up: Another LMT Strategy?

- Violation of the Prepetition Pari Passu Intercreditor Agreement

"SECTION 2.01. Priority of Claims. (a) Anything contained herein or in any of the Secured Credit Documents to the contrary notwithstanding (but subject to Section 1.01(b)), if an Event of Default has occurred and is continuing, and the Applicable Authorized Representative or any Secured Party is taking action to enforce rights in respect of any Shared Collateral, ***or any distribution is made in respect of Shared Collateral in any Bankruptcy Case*** [(emphasis added)] of any Pledgor or any Secured Party receives any payment pursuant to any intercreditor agreement (other than this Agreement) with respect to any Shared Collateral, the proceeds of any sale, collection or other liquidation of any such Shared Collateral by any Secured Party or received by the Applicable Authorized Representative or any Secured Party pursuant to any such intercreditor agreement with respect to such Shared Collateral and proceeds of any such distribution (subject, in the case of any such distribution, to the sentence immediately following) to which the Obligations are entitled under any intercreditor agreement (other than this Agreement) (all proceeds of any sale, collection or other liquidation of any Collateral and all proceeds of any such distribution being collectively referred to as "Proceeds"), shall be applied (i) FIRST, to the payment of all amounts owing to each Authorized Representative (in its capacity as such) pursuant to the terms of any applicable Secured Credit Document on a pari passu basis and (ii) SECOND, subject to Section 1.01(b), to the payment in full of the Obligations of each Series on a pro rata basis, with the payment so allocated to each Series to be applied to the Obligations of such Series in accordance with the terms of the Credit Documents."

Non-Pro Rata Roll-Up: Another LMT Strategy?

- Violation of the payments provision in the applicable prepetition 2L term loan credit agreement

"SECTION 2.13. Sharing of Payments. If, other than as expressly provided elsewhere herein, any Lender shall obtain on account of the Loans made by it, ***any payment (whether voluntary, involuntary, through the exercise of any right of setoff, or otherwise) in excess of its ratable share*** [(emphasis added)] (or other share contemplated hereunder) thereof, such Lender shall immediately (a) notify the Administrative Agent of such fact and (b) purchase from the other Lenders such participations in the Loans made by them, as shall be necessary to cause such Purchasing Lender to share the excess payment in respect of such Loans or such participations, as the case may be, pro rata with each of them; provided that if all or any portion of such excess payment is thereafter recovered from the purchasing Lender under any of the circumstances described in Section 10.06 (including pursuant to any settlement entered into by the purchasing Lender in its discretion), such purchase shall to that extent be rescinded and each other Lender shall repay to the purchasing Lender the purchase price paid therefor, together with an amount equal to such paying Lender's ratable share (according to the proportion of (i) the amount of such paying Lender's required repayment to (ii) the total amount so recovered from the purchasing Lender) of any interest or other amount paid or payable by the purchasing Lender in respect of the total amount so recovered, without further interest thereon."

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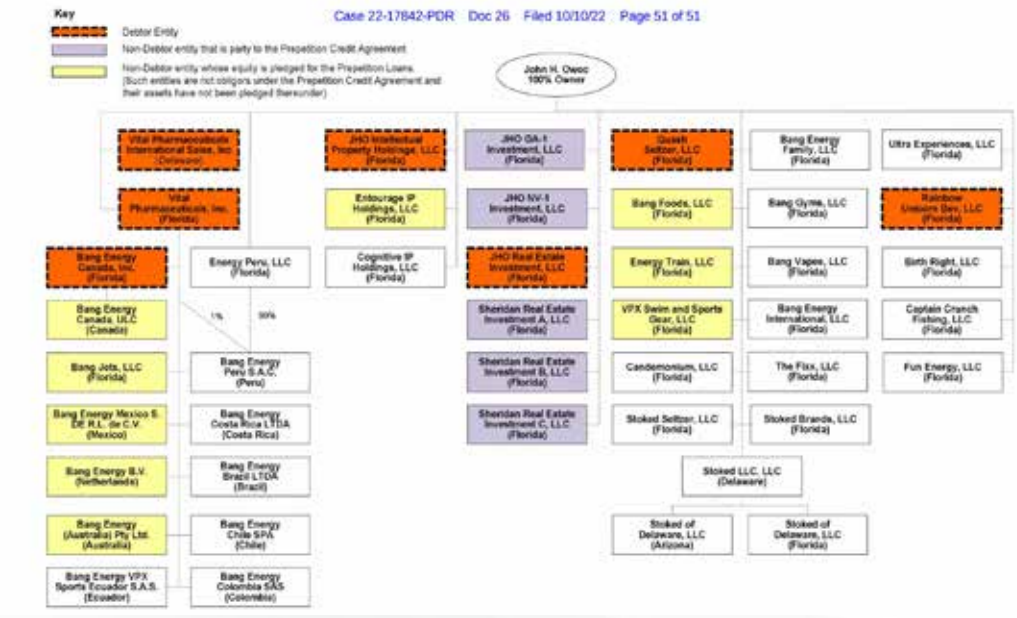
Addressing Corporate Governance (Case Study)



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Features of Main Street Lending Program Loans

- 1,830 MSLP loans made, through January 8, 2021
- Interest Rate = 1 or 3 month SOFR + 3.11.448 or 326.161 basis points
- 5 year term
  - Year 1 – no P&I payments, interest capitalized
  - Year 2 – interest only payments
  - Year 3 – 15% of principal amortizing and due
  - Year 4 – 15% of principal amortizing and due
  - Year 5 – 70% principal balloon payment due

MSLP SPV Loan Participations
(as of December 31, 2023, in thousands)*

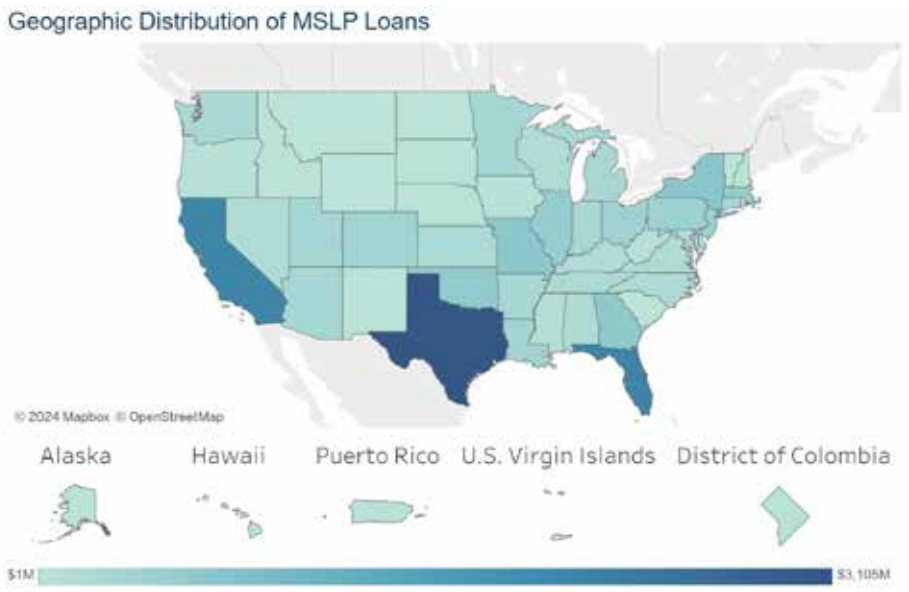
Total principal outstanding ----------$ 7,777,993

Charge-offs in 2023 ----------$ 438,515

Allowance for credit losses ----------$ 840,828

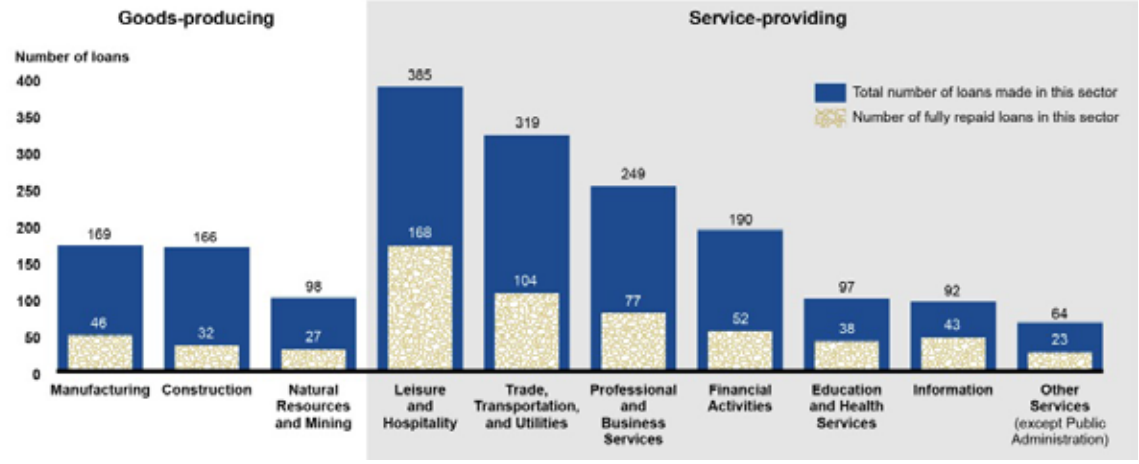
Loans on non-accrual status (at least 90 days past due) -- **$ 1.3 billion**

* Financial Statements: MS Facilities LLC for the years ended December 31, 2023 and 2022 and Independent Auditor's Report



Source: Federal Reserve Main Street Lending Program Dashboard

Figure 22: Number and Dollar Amount of Fully Repaid Main Street Loans, by Sector, as of August 2023



Source: U.S. Government Accountability Office Report to Congressional Committees, Dec. 2023, GAO-24-106482

Challenges Presented by MSLP Loans

- 95% of each loan is participated to a Federal Reserve SPV
- MSLP loans are not forgiveable
- "Core Rights Acts" can be undertaken only by instruction of the SPV
  - Any "action (or inaction) that would result in":
    - Reduction of principal, interest or fees
    - Extension of payment dates
    - Release of collateral
    - Subordination of MSLP Loans
    - Others

MSLP Modifications as of December 31, 2023*

Modification	Service Industry (in thousands)	Non-Service Industry (in thousands)	Number
Interest pmt. deferral (12 mos.)	$5,187	-	1
Principal pmt. deferral (2 – 24 mos.)	$309,842	$77,863	26
P & I pmt. deferral (7 – 27 mos.)	$27,901	$27,251	2
Maturity extension and Principal payment deferral (one year)	$11,843	-	1
Total	$354,773	$105,114	30

* Financial Statements: MS Facilities LLC for the years ended December 31, 2023 and 2022 and Independent Auditor's Report, accessed 4.2.24 at https://www.federalreserve.gov/aboutthefed/files/msllcfinstmt2022.pdf

DIP Statistics excerpts from:

- 76 DIP financing provided in 1H 2023 within the coverage universe of $10 million or more in funded debt at time of filing
- 41 are in the "prime market" = at least USD 150m of funded debt commitments
- 35 are in the "middle market" = less than $150m of funded debt

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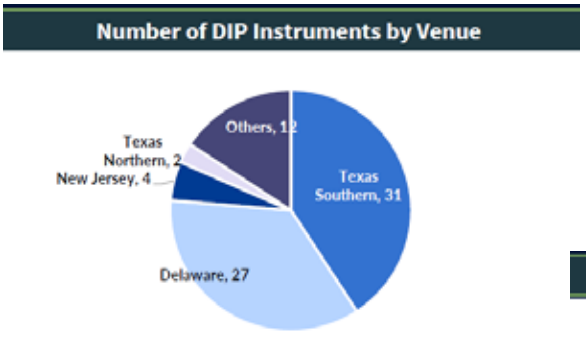

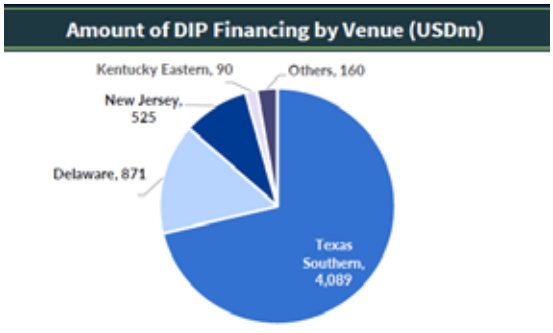

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Interest Rate	Number of DIPs	Prime/ Middle Market
<3%	0	0/0
≥3% and <6%	3	1/2
≥6% and <9%	2	1/1
≥9% and <12%	4	4/0
≥12%	26	17/9

Interest Rates. Interest rates are much higher in 1H23 than in the comparable period in 2022. In 1H23, 86% of DIP instruments had interest rates over 9%. The USD 75m DIP revolver of **David's Bridal** had the highest rate, which was Prime Rate + 12.5%. Additionally, we continue to see that some of the highest rates on DIP financings were found in some of the smallest DIPs in 1H23: **Beverly Community Hospital Association** at SOFR +12% and **Plastiq** at SOFR+12%.

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Fees	Number of DIPs	Prime/ Middle Market
<3%	39	14/11
≥3% and <6%	2	1/1
≥6% and <9%	3	3/0
≥9% and <12%	0	0/0
≥12%	5	5/0

Fees. Commitment (or upfront) and exit fees of over 2% continue to be rare. Notable exceptions include the 6% commitment fee and 10% exit fee in **Performance Powersports Group**, 10% commitment fee and 6% exit fee in **Vice Media**, and 8% commitment fee in **Party City**. In addition to the typical fees, some DIPs also included substantial backstop fees, including **Instant Brands** (10%) and **Venator Materials** (10%).

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All-in Cost: Interest + Fees	Number of DIPs	Prime/ Middle Market
<3%	14	0/0
≥3% and <6%	2	0/2
≥6% and <9%	2	1/1
≥9% and <12%	4	4/0
≥12%	27	18/9

All-in Cost. Party City had the highest annualized all-in DIP financing cost of any debtor in 1H23, at 39.2% of the DIP proceeds (this financing is notable for having the highest fees and among the highest interest rates). David's Bridal's DIP facility had total annualized costs at 36.6%. Note, however, that a number of DIP financing fees are sealed or undisclosed, which likely skews the number of DIPs with lower all-in costs (including in some of the larger, higher-profile cases). DIPs provided by affiliates or asset bidders tend to be lower cost than financing from third parties or from prepetition lenders.

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Lender	Number of DIPs
Defensive Lender	**61**
Pre-petition Lender / Equity Holder	58
Non-debtor Affiliate / Management	3
Third Party Lender	**15**
Stalking Horse Bidder	2
True Third Party	13

Lender Types. The vast majority of DIP lenders were interested parties, including creditors seeking to protect their pre-petition debt position and non-debtor affiliates.

Only USD 321m (~5%) of DIP funding in 1H23 came from third-party lenders, including stalking horse bidders that were not prepetition creditors or what we have deemed "true third-party DIP lenders," which are entities that before and apart from becoming DIP lenders had no meaningful connection to a debtor. Only 13 DIP loans came from true third-party lenders.

The largest DIPs provided by third-party lenders in 1H23 were (1) **Rialto Bioenergy Facility's** USD 35m DIP term loan provided by **Legalist** and (2) the USD 10m **Paradox Resources'** USD 13.8m DIP term loan facility also provided by Legalist.

About 93% of the DIP financing dollars in 1H23 were provided by pre-petition creditors or equity holders, which is at the same level compared to 1H 2022 (94%).

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Length of Time	Number of DIPs	Prime/ Middle Market	Amount (USDm)
<3 Months	13	4/9	262
≥3 Months and <6 Months	34	17/17	1,935
≥6 Months and <9 Months	14	11/3	1,771
≥9 Months and <12 Months	2	1/1	319
≥12 Months	4	2/2	840
N/A	9	6/3	607
Total	**76**	**41/35**	**5,735**

Maturities. The vast majority of DIPs had a maturity date of less than one year, though 17% of the instruments had a maturity date of at least one year in 1H23, which was slightly lower than last year (19%). **Rialto Bioenergy Facility**'s DIP term loan has the longest maturity of 18 months.

DIPs over USD 10m with under six-month maturities are rare, and some examples of short-term DIP lending include, **Party City, SiO2 Medical Products, Bed Bath & Beyond, QualTek Services**, and **Venator Materials.**

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Roll-up/Refi	Number of Cases	Amount Rolled (USDm)
Roll-up/Refi	22	1,905**
No Roll-up/Refi	42	-

Roll-ups. 22 of 64, or approximately 34% of cases with DIP financings, rolled up (or refinanced) prepetition debt into the DIP package in 1H23, which is lower than 1H22's 39%. This breaks the trend since 2016 of around half of the DIP financings involving a roll-up/refi component.

The largest 1H23 roll-up/refinancing of prepetition funded debt was in **Genesis Care**, whose term loan rolled up USD 600m of prepetition debt. **IEH Auto Parts** comes in second place with a roll-up of USD 211m of outstanding amounts under its prepetition term B facility and LC exposure.

In total, USD 1,905m was rolled-up or refinanced via DIPs in 1H23, which is more than doubled than last year's USD 745m.

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Notable Company*	Roll-up Amount (USDm)	New Money Amount (USDm)	Total DIP Financing (USDm)	% Roll-up
Genesis Care Pty Ltd	600	200	800	75.0%
IEH Auto Parts Holding LLC (Auto Plus)	211	75	286	73.8%
Bed Bath & Beyond Inc.	200	40	240	83.3%
Venator Materials	190	275	465	40.9%
Mountain Express Oil Company	85	1	86	99.1%
QualTek Services Inc.	67	141	208	32.1%
The Rockport Company LLC (2023)	66	7	73	90.5%
SiO2 Medical Products Inc	60	60	120	50.0%
Vice Media Group LLC	50	10	60	83.3%
Cyxtera Technologies Inc	50	150	200	25.0%
PGX Holdings Inc. (Credit.com)	43	20	63	68.2%
Virgin Orbit Holdings Inc.	43	32	74	57.4%
Nova Wildcat Shur-Line Holdings Inc.	42	6	49	87.4%
Invacare Corp.	41	47	87	46.7%
Center for Autism and Related Disorders LLC	33	18	51	64.3%

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DIP Collateral	Number of DIPs	Prime/ Middle Market	Amount (USDm)
All Assets	72	39/33	5,600
Not All Assets	4	2/2	135

Priming Liens	Number of DIPs	Prime/ Middle Market	Amount (USDm)
DIP liens prime all prepetition liens	48	23/25	3,237
DIP liens are junior to certain prepetition liens	28	18/10	2,498

In the chart above, "primes all prepetition liens" indicates that DIP liens prime all other liens except Permitted Prior Liens, generally defined in court documents as liens permitted to carry out ordinary course business under the typical credit agreement or indenture.

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Investigation Budget. There were seven debtors for which the DIP orders provided investigation budgets of USD 100,000 or greater. The largest was **Tehum Care Services**, with an investigation budget of USD 500,000.

Investigation Deadline. A length of 60-75 days was again the sweet spot for investigation deadlines approved in final DIP orders. The longest deadline is 75 days, and 41 DIP orders have an investigation deadline of 75 days. The shortest was a deadline of 30 days in **Vice Media Group** and **Nielsen & Bainbridge.**

Carve-Out. The professional fee carve-outs (post trigger-notice professional fee caps) provided in final DIP orders ranged from highs of USD 10m for **Avaya**, to tiny amounts (USD 10,000) in smaller case such as **File Storage Partners.**

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* Financial Statements: MS Facilities LLC for the years ended December 31, 2023 and 2022 and Independent Auditor's Report

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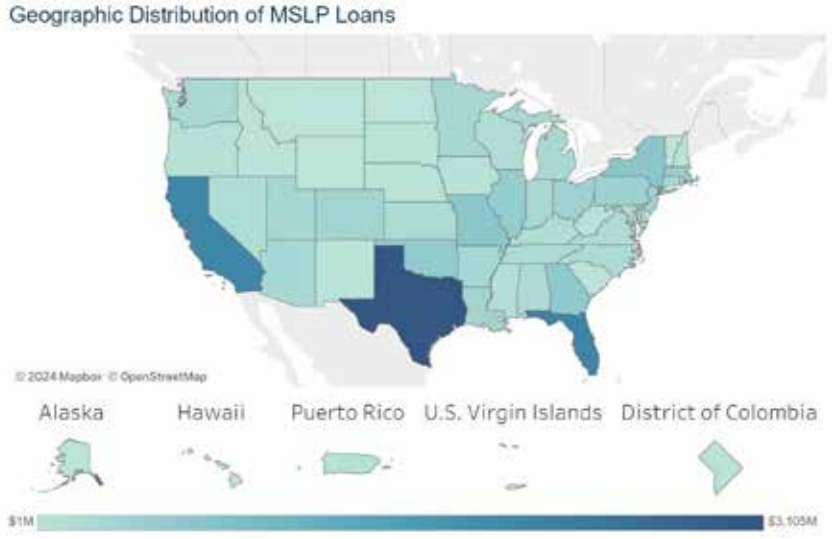

Source: Federal Reserve Main Street Lending Program Dashboard

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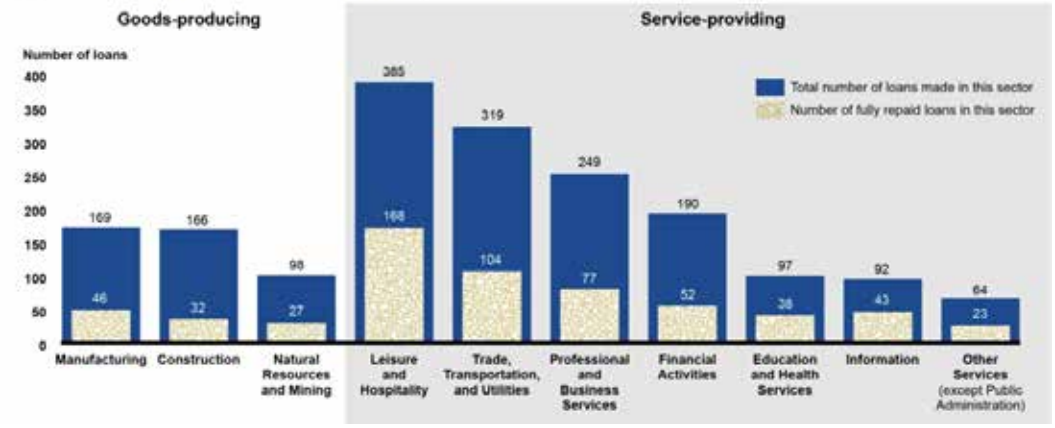
Figure 22: Number and Dollar Amount of Fully Repaid Main Street Loans, by Sector, as of August 2023



Source: U.S. Government Accountability Office Report to Congressional Committees, Dec. 2023, GAO-24-106482

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Challenges Presented by MSLP Loans

- 95% of each loan is participated to a Federal Reserve SPV
- MSLP loans are not forgivable
- "Core Rights Acts" can be undertaken only by instruction of the SPV
  - **Any "action (or inaction) that would result in":**
    - Reduction of principal, interest or fees
    - Extension of payment dates
    - Release of collateral
    - Subordination of MSLP Loans
    - Others

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MSLP Modifications as of December 31, 2023*

Modification	Service Industry (in thousands)	Non-Service Industry (in thousands)	Number
Interest pmt. deferral (12 mos.)	$5,187	-	1
Principal pmt. deferral (2 – 24 mos.)	$309,842	$77,863	26
P & I pmt. deferral (7 – 27 mos.)	$27,901	$27,251	2
Maturity extension and Principal payment deferral (one year)	$11,843	-	1
Total	$354,773	$105,114	30

* Financial Statements: MS Facilities LLC for the years ended December 31, 2023 and 2022 and Independent Auditor's Report, accessed 4.2.24 at https://www.federalreserve.gov/aboutthefed/files/msllcfinstmt2022.pdf

When Do DIP Protections Go Too Far?

- DIP lenders routinely get superpriority claims and adequate protection claims and liens for supplying "new value" to Chapter 11 debtors.
  - Debtors are permitted to exercise their business judgment with respect to the terms of that financing, including milestones and other case-control mechanisms.
- But there are limits:
  - A DIP cannot establish plan terms *sub rosa*: "A touchstone consideration in conducting that analysis is whether the proposed terms would prejudice the powers and rights that the Code confers for the benefit of all creditors and leverage the Chapter 11 process by granting the lender excessive control over the debtor or its assets as to unduly prejudice the rights of other parties in interest." *In re LATAM Airlines*, 620 B.R. 722, 816 (Bankr. S.D.N.Y. 2020).

When Do DIP Protections Go Too Far?

- Examples of *sub rosa* provisions in DIPs:
  - DIP Lender would receive controlling equity interest in Debtor. (*In re Belk Props., LLC*, 421 B.R. 221 (Bankr. N.D. Miss. 2009)).
  - Size of DIP loan was so large in relation to all estimates of value that it would wipe out any possibility of recovery for subordinate lienholders. (*In re Lafitte's Harbor Dev't*, 2018 WL 272781 (Bankr. S.D. Tex. 2018)).
  - DIP loan able to be repaid in new equity issued at a 20% discount to plan value, without a market test. (*In re LATAM Airlines*).
  - Plan must be approved by DIP Lenders, or an Event of Default will be triggered. (*In re LATAM Airlines*; *In re Belk Props., LLC*).

The Game Of Chicken: What Will Courts Approve?

- Examples of terms ***initially*** demanded by DIP lenders (unusual→generic)
  - No challenge period. (*WeWork*).
  - Event of default if any party files a motion seeking to challenge prepetition liens or takes any action adverse to pre-petition lenders (*NanoString*).
  - 3-to-1 roll-up (*Thrasio*).
  - Consent over plan terms or event of default if plan does not repay DIP Lenders' pre-petition debt in full in cash (*Revlon*, *Nanostring*).
  - Liens on proceeds of avoidance actions--against DIP Lenders (*Revlon*).
  - Anti-marshalling provisions (and waivers of Section 506(c) and 552(b) protections).
    - in *NanoString*, express requirement to use asset sale proceeds to first pay prepetition debt of DIP Lenders.
  - Exit financing/backstop rights at discount to plan value (*Enviva*).
  - Challenge periods too short, budgets too small for a thorough investigation.
  - Case milestones too short to meaningfully permit competing bids.
- **Has there been a paradigm shift caused by aggressive lender demands?**

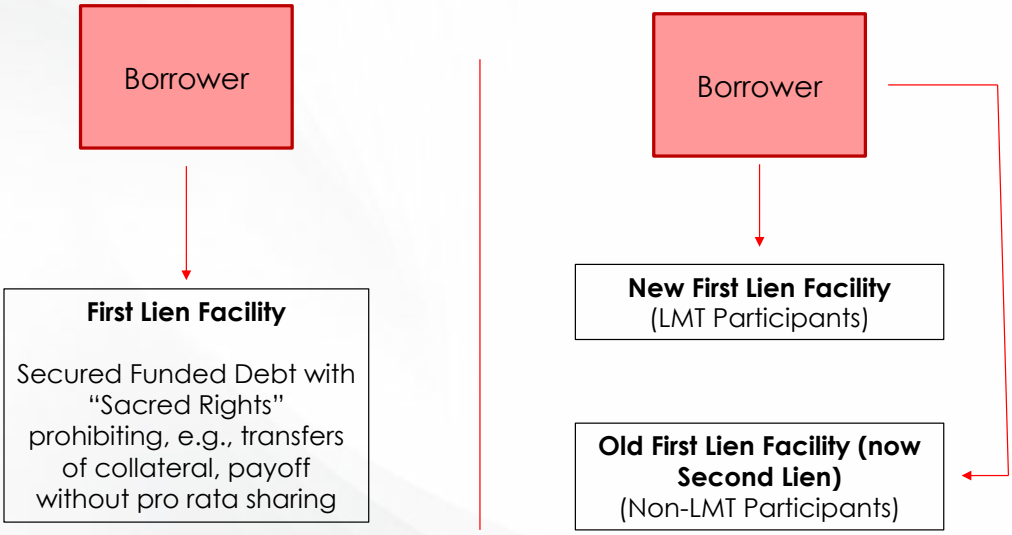
DIP Financing as "Step 2" of Liability Management

- Step 1: Liability Management Transaction
- Step 2: DIP Financing from favored LMT participants
  - Frequently including stringent case-control provisions, ensures protection from LMT challenges.
- Step 3: Case-exit strategy devised by favored LMT participants
  - Can be exit financing, equity, funded backstop, or any combination.

Step 1: What Is a Liability Management Transaction?

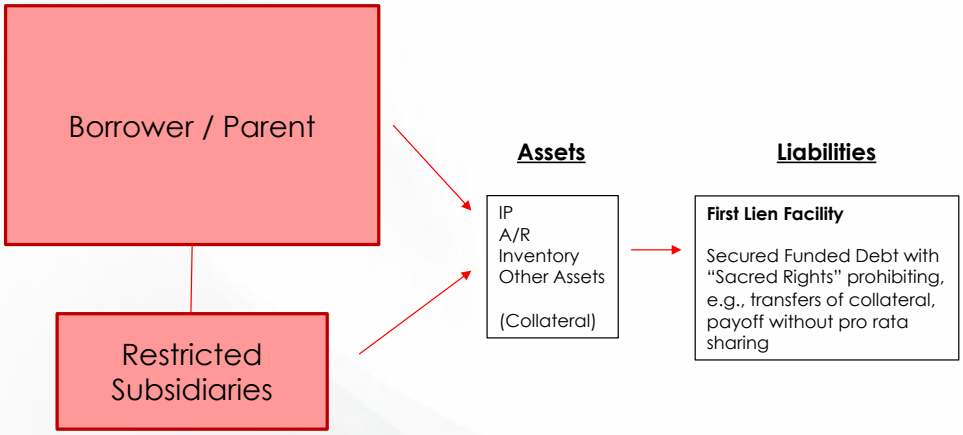
- A "liability management transaction" (LMT) is a transaction in which certain lenders modify the terms of an existing loan or indenture to permit the company to issue new secured debt to favored parties funded through new money, exchanges/rollups of old debt, or a combination of the two, effectively subordinating non-participating lenders.
- "Uptier Exchange": Majority lenders exchange their debt on a non-pro-rata basis for new senior secured debt.
- "Drop-Down" Transaction (The "J.Crew"): Company creates new unrestricted subsidiaries; majority lenders consent to amending contract to permit "drop-down" of prime collateral to new subs; majority lenders then roll up old debt into new loan to new subs as borrowers, secured by prime collateral.
  - In "covenant-lite" loans, there may be space for these transactions under the terms of the existing document.
  - But these transactions may (and often do) trigger litigation by non-participating lenders for violation of "sacred rights."

Uptier: Before and After



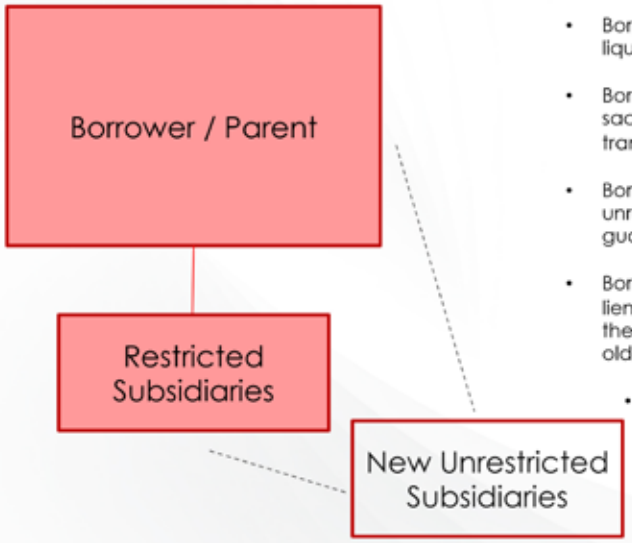
As part of the transaction, majority lenders may amend documents to change open-market provisions, strip covenants, permit issuance of new superpriority tranches, subordinate existing loans, reduce principal amount of existing loans (to permit roll-ups).

Drop-Down: The Borrower "Before"



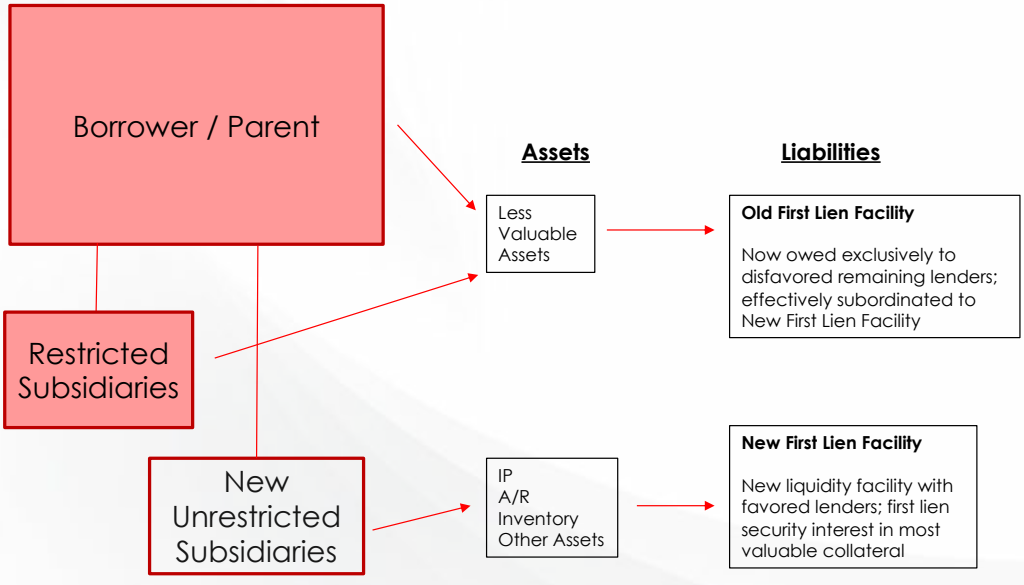
Restricted subsidiaries: entities required to comply with loan covenants, guaranty the loan and pledge collateral, and together with the parent borrower, restricted from certain investments and debt transactions. A borrower may also have unrestricted subsidiaries (e.g., foreign subsidiaries or defunct entities).

Drop-Down: The Transaction



- Borrower engages majority of lenders for liquidity transaction
- Borrower and favored lenders amend "non-sacred" loan provisions to permit limited transfers to unrestricted subsidiaries
- Borrower transfers collateral assets to unrestricted subsidiaries (that are not guarantors of existing debt)
- Borrower and favored lenders execute new first lien facility to borrow against new subs and their assets; roll up favored lender holdings in old first lien facility into new facility
  - Borrower may need to call the roll-up an "open market" transaction to evade sacred pro rata sharing obligations

Drop-Down: The Borrower "After"



Step 2: LMT Facility Becomes DIP

- Intercreditor Litigation is Stayed.
  - Debtor now (in the first instance) has standing to bring fraudulent transfer litigation.
- Liens on favored assets are "hardened."
  - Challenge period and budget governed by DIP terms.
- Adequate Protection liens are granted.
  - Frequently include liens on proceeds of avoidance actions—maybe even actions against DIP Lenders.
- DIP Lenders have important case controls.
  - Consent to venue.
  - Milestones.
  - Consent to plan (including exit provisions/financing).

Non-Pro Rata Roll-Up: Another LMT Strategy?

- *Sungard AS New Holdings, LLC, et al.* (No. 22-90018; S.D. Texas)
  - Prepetition capital stack included an ABL facility, a 1L term facility and two 2L term facilities (that as between them shared collateral on a *pari passu* basis).
  - Court approved DIP financing that, *inter alia*, permitted only the 1L prepetition lenders to roll up their respective prepetition term loans on a 1:2 ratio of new money financing to roll-up loans.
  - Any DIP lender that did not achieve the 1:2 ratio based solely on rolling up its 1L term loan position could also roll-up its 2L term loan position to achieve such ratio.
  - 2L prepetition lenders that did not also hold any 1L prepetition term loans excluded from the DIP financing (and the roll-up feature).
  - DIP financing ultimately not contested by the 2L term loan lenders that did not hold 1L term loans, but what if it had been?

Non-Pro Rata Roll-Up: Another LMT Strategy?

- Possible Arguments Against Non-Pro Rata Roll Up in *Sungard*
  - Neither reasonable nor necessary to the DIP facility.
  - Unreasonably and unnecessarily shifts costs related to the DIP facility from the Debtors' estates to the excluded 2L Lenders.
  - Violates the provisions of the prepetition *pari passu* intercreditor agreement (as between the two 2L term loan facilities).
  - Violates the sharing of payments provision within each prepetition 2L term loan credit agreement.
  - Violates 11 U.S.C. § 1123(a)(4) by adjusting priorities within a class of similarly situated creditors, specifically the prepetition 2L lenders.

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Non-Pro Rata Roll-Up: Another LMT Strategy?

- Violation of the Prepetition Pari Passu Intercreditor Agreement

"SECTION 2.01. Priority of Claims. (a) Anything contained herein or in any of the Secured Credit Documents to the contrary notwithstanding (but subject to Section 1.01(b)), if an Event of Default has occurred and is continuing, and the Applicable Authorized Representative or any Secured Party is taking action to enforce rights in respect of any Shared Collateral, ***or any distribution is made in respect of Shared Collateral in any Bankruptcy Case*** [(emphasis added)] of any Pledgor or any Secured Party receives any payment pursuant to any intercreditor agreement (other than this Agreement) with respect to any Shared Collateral, the proceeds of any sale, collection or other liquidation of any such Shared Collateral by any Secured Party or received by the Applicable Authorized Representative or any Secured Party pursuant to any such intercreditor agreement with respect to such Shared Collateral and proceeds of any such distribution (subject, in the case of any such distribution, to the sentence immediately following) to which the Obligations are entitled under any intercreditor agreement (other than this Agreement) (all proceeds of any sale, collection or other liquidation of any Collateral and all proceeds of any such distribution being collectively referred to as "Proceeds"), shall be applied (i) FIRST, to the payment of all amounts owing to each Authorized Representative (in its capacity as such) pursuant to the terms of any applicable Secured Credit Document on a pari passu basis and (ii) SECOND, subject to Section 1.01(b), to the payment in full of the Obligations of each Series on a pro rata basis, with the payment so allocated to each Series to be applied to the Obligations of such Series in accordance with the terms of the Credit Documents."

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Non-Pro Rata Roll-Up: Another LMT Strategy?

- Violation of the payments provision in the applicable prepetition 2L term loan credit agreement

"SECTION 2.13. Sharing of Payments. If, other than as expressly provided elsewhere herein, any Lender shall obtain on account of the Loans made by it, ***any payment (whether voluntary, involuntary, through the exercise of any right of setoff, or otherwise) in excess of its ratable share*** [(emphasis added)] (or other share contemplated hereunder) thereof, such Lender shall immediately (a) notify the Administrative Agent of such fact and (b) purchase from the other Lenders such participations in the Loans made by them, as shall be necessary to cause such Purchasing Lender to share the excess payment in respect of such Loans or such participations, as the case may be, pro rata with each of them; provided that if all or any portion of such excess payment is thereafter recovered from the purchasing Lender under any of the circumstances described in Section 10.06 (including pursuant to any settlement entered into by the purchasing Lender in its discretion), such purchase shall to that extent be rescinded and each other Lender shall repay to the purchasing Lender the purchase price paid therefor, together with an amount equal to such paying Lender's ratable share (according to the proportion of (i) the amount of such paying Lender's required repayment to (ii) the total amount so recovered from the purchasing Lender) of any interest or other amount paid or payable by the purchasing Lender in respect of the total amount so recovered, without further interest thereon."

Step 3: Exit

- Cash is not king for LMT/DIP Lenders.
- DIP Facility generally provides the architecture of the exit deal:
  - Equity? Warrants? Takeback paper? Backstop rights? Some combination?
  - Do the math: does the type/amount of that currency over-compensate DIP Lenders, given a particular valuation? Complicated structures can mask unexpected recovery rates.
- Sets the stage for a valuation trial at confirmation. Very expensive on all sides, allows for further settlement discussions.

Case Study: Revlon

- 2019 and 2020: Revlon conducts two separate "drop-down" transactions transferring valuable IP to new "BrandCo" subsidiaries. These BrandCos issue new debt to certain Revlon term loan lenders, rolling up their existing debt to the parent.
- August 2020: "Objecting" lenders sue. Litigation is complicated by Citibank's accidental payment in full to lenders.
- June 15, 2022: Revlon files for Chapter 11, with BrandCo Lenders as DIP Lenders.
- June 24, 2022: UST appoints Committee.
- July/Aug 2022: DIP trial

Case Study: Revlon

- Certain Proposed DIP Terms:
  - "Acceptable Plan": requires consent of DIP Lenders or repayment in full in cash of *pre-petition* BrandCo debt.
  - Adequate Protection Liens: Include liens on proceeds of avoidance actions and all other actions *against BrandCo Lenders*.
  - Marshalling waivers allow DIP lenders to look to these proceeds first, and to look to assets of parent and other operating subs where their pre-petition liens are shared, rather than having to look first to BrandCo assets where they have exclusive pre-petition liens.

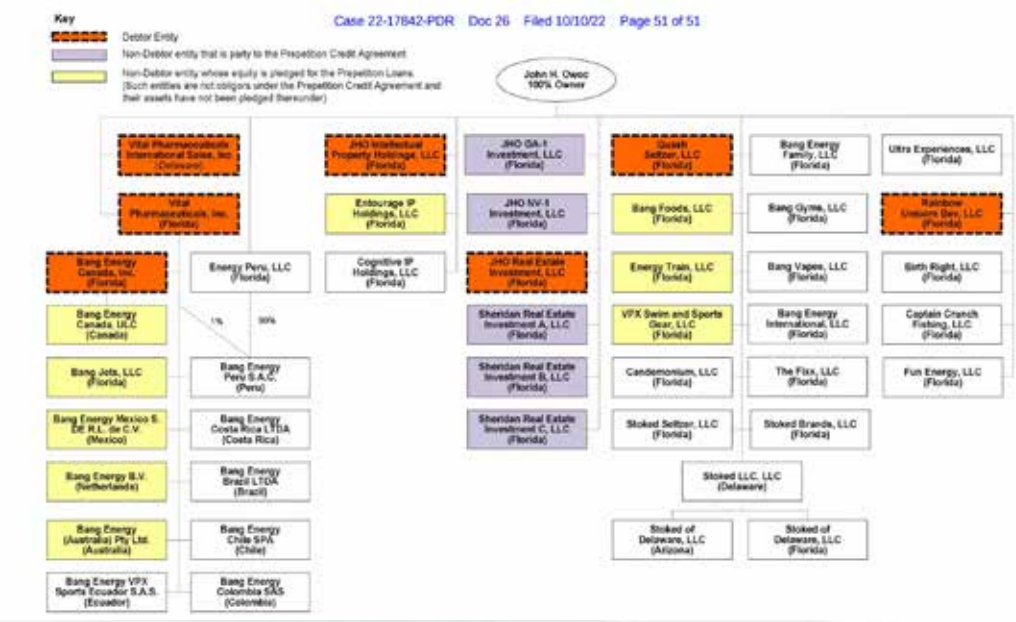
Case Study: Revlon

- Certain Proposed DIP Terms (cont.):
  - Challenge: 75-day challenge period (tolls upon filing of standing motion); total budget of $50,000.
  - Milestones: Require Company to enter RSA/file Plan before holiday revenue is known, during company's busiest and most important period.
- UCC raised objections to each, including arguments that the DIP is effectively a *sub rosa* plan.

Case Study: Revlon

- DIP Trial: Two-day evidentiary trial.
- Court "signaled" from the bench that he would approve DIP; indicated some discomfort with certain provisions; encouraged parties to keep negotiating.
- Final DIP Order entered with key concessions that framed the rest of the case:
  - Challenge period extended from 75 days to 90 days.
  - Budget increased from $50k to $350k, with clarification that excess can be admin claims.
  - Two-week extension for RSA/Plan.
  - Preserved court's ability to modify provisions of Final DIP Order relating to adequate protection (based on outcome of challenge).
- End of case: BrandCo Lenders received vast majority of equity in reorganized company and take-back loans equal to their pre-petition claims. "Objecting lenders" got minority equity interests. Unsecured creditors received $44 million in cash.

Addressing Corporate Governance (Case Study)



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Faculty

Shari I. Dwoskin is a partner in Brown Rudnick LLP's Bankruptcy & Corporate Restructuring Practice Group in Boston. She represents creditors' committees, tort victims, bondholders, equity interestholders, and debtors in chapter 11 restructurings and litigation arising from related disputes, as well as out-of-court wind-downs. Ms. Dwoskin has experience managing many facets of the restructuring process in some of the largest recent bankruptcy cases, including negotiating restructuring support agreements, plans and DIPs; plan-confirmation trials; valuation; avoidance actions; bankruptcy auctions; the claims-resolution process; and related motion practice and litigation. She also regularly consults with Brown Rudnick's Corporate, Intellectual Property and Real Estate Groups on bankruptcy-related matters. Ms. Dwoskin co-chairs the New England Network of the International Women's Insolvency & Restructuring Confederation (IWIRC) and was named an Up and Coming Lawyer by *Massachusetts Lawyers Weekly* in 2021. She received her B.A. in 2002 from McGill University, her M.A. in 2006 from Harvard University and her J.D. in 2014 from Harvard University, where she was editor-in-chief of the *American Criminal Law Review* and was a member of the Georgetown Law Barristers' Council, Appellate Advocacy Division.

Luis M. Lluberas is a member in the Bankruptcy & Financial Restructuring practice group of Moore & Van Allen, PLLC in Charlotte, N.C., where his practice encompasses a broad range of financial services matters, with a focus on the resolution of troubled credits. He has experience representing key stakeholders in connection with all aspects of financial restructuring matters in myriad industries, and routinely represents financial institutions, in both lender and agent capacities, in syndicated credit facilities and other lending transactions. He is also a member of the firm's Diversity Committee and Attorney Development Committee, and is a co-chair of the firm's Lawyers of Color affinity group. In 2015, Mr. Lluberas received the Turnaround Management Association's Turnaround of the Year: Small Company award for his work as legal counsel to the receiver in the Bost Distributing Co. matter. The *Charlotte Business Journal* honored him as one of its 2018 40 Under 40 recipients, and each year since 2014, he has been recognized as a Rising Star in business bankruptcy in *North Carolina Super Lawyers* magazine. Mr. Lluberas serves as the General Counsel for the Charlotte Regional Business Alliance, a collaboration among 15 counties focused on the promotion and advancement of the Charlotte region. He received his B.A. with highest distinction and his J.D. with honors from the University of North Carolina at Chapel Hill.

Kenneth W. Mann is the managing director for the Special Situations practice at SC&H Capital in Ellicott City, Md., where he provides healthy and distressed M&A, employee stock ownership plans (ESOP) and business valuation advisory for middle-market companies. He has been providing going concern solutions (debt, equity, entirety sale) to distressed businesses for 30 years. Prior to joining SC&H Capital in 2020, Mr. Mann had served as the managing director of Equity Partners, providing going-concern solutions (debt, equity, entirety sale) to distressed businesses. His team has completed more than 650 transactions with troubled companies, including more than 300 approved transactions in 72 bankruptcy court districts. Mr. Mann has personally handled investment banking services for hundreds of companies in a host of industries. In chapter 11 cases, he has served as investment banker, bid examiner and expert witness, and he has testified more than 150 times in support of transactions produced by the firm. Mr. Mann has been a speaker at events hosted by ABI and the

Turnaround Management Association (TMA), Florida Bar, Association of Insolvency & Restructuring Advisors (AIRA) and Mississippi Bankruptcy Conference, and he has been an author for ABI, TMA, and various secured lender trade and general business publications. He was named "Distressed M&A Dealmaker of the Year" by M&A Advisors and a "Top 100 Restructuring Professional" by *Turnarounds & Workouts*. Mr. Mann currently serves on ABI's Board of Directors and on the board of TMA's Chesapeake Chapter. Prior to joining Equity Partners, Mr. Mann's experience included investment banking, public relations and marketing consulting, and he has owned and exited several successful businesses. He holds Series 7, 63 and 79 licenses, and he has been a licensed real estate agent since 2008. Mr. Mann received his Bachelor's degree with honors in business administration with a marketing concentration from Salisbury University.

Lisa Bittle Tancredi is Of Counsel at Womble Bond Dickinson (US) LLP in Baltimore and Wilmington, Del. She focuses her practice on restructuring, bankruptcy and creditors' rights matters. Ms. Tancredi represents a wide range of clients, including financial institutions, funds, sureties, receivers, landlords, businesses, suppliers and contract counterparties, purchasers, and high-net-worth individuals, both inside and outside of bankruptcy court. In the syndicated loan arena, she works with agents and participating lenders to address distressed-debt facilities. Ms. Tancredi designs and leads regular seminars for local and national groups and has authored a number of articles and publications. She co-authored ABI's *Navigating Banking in Bankruptcy: A Guidebook*, which informs bankers and advisors about the treatment of cash management and bank products in bankruptcy. She is also ranked as a leading lawyer for bankruptcy/restructuring in Maryland by *Chambers USA* and has been listed as a top-rated bankruptcy attorney in Baltimore by *Super Lawyers* since 2011. Ms. Tancredi's background is in mechanical engineering, but she acquired her affinity for bankruptcy during a law school clerkship with the Office of the U.S. Trustee. Following law school, she clerked for the late Hon. James F. Schneider of the U.S. Bankruptcy Court for the District of Maryland. Over the course of her more than 25 years of practice, Ms. Tancredi has appeared in bankruptcy courts around the country representing a broad spectrum of constituencies, from estate fiduciaries and governmental authorities to creditors and interested parties. She currently co-chairs ABI's Mid-Atlantic Bankruptcy Workshop, is a member of the board of directors of IWIRC's Greater Maryland Network, chairs the Maryland Bankruptcy Bar Association's U.S. District Court Liaison Committee, is a commissioner on the Baltimore County Ethics Commission, is a member of the Severn Bank Women's Advisory Board and is a member of the board of directors of the USS Landing Craft Infantry National Association. In addition, she is a past president of the Maryland Bankruptcy Bar Association and a former chair of the Maryland Local Bankruptcy Rules Committee. Ms. Tancredi received her B.S. in mechanical engineering *cum laude* from Virginia Tech and her J.D. from the University of Maryland School of Law.

Hon. Mary F. Walrath is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington, appointed in 1998. She served as Chief Bankruptcy Judge from 2003-08. Judge Walrath previously clerked for Hon. Emil F. Goldhaber, Chief Bankruptcy Judge for the Eastern District of Pennsylvania, and was an attorney at Clark Ladner Fortenbaugh & Young in Philadelphia, concentrating in the areas of debtor/creditor rights and commercial litigation. In addition to speaking at numerous bankruptcy educational programs and panels throughout the country, Judge Walrath is a founding member and co-president of the Delaware Bankruptcy American Inn of Court, a member of the Delaware Chapter of the International Women's Insolvency & Restructuring Confederation (IWIRC), a member of ABI and a Fellow in the American College of Bankruptcy. She is also an editor of the *Rutter Group Bankruptcy Practice Guide*. Judge Walrath is active in the National Conference of Bankruptcy Judges

(NCBJ), having served on its Board of Governors from 2007-12, as secretary from 2013-14, as chair of its Education Committee from 2014-15 and as president from 2016-17. Judge Walrath served as an associate editor and then business manager of the *American Bankruptcy Law Journal* from 2009-15. She also testified before the House Judiciary Committee on H.R. 1667, the Financial Institution Bankruptcy Act of 2017. Judge Walrath received her A.B. in history from Princeton University and earned her J.D. *cum laude* from Villanova University, where she was a member of the *Villanova Law Review* and was awarded the Order of the Coif.