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CONCURRENT SESSION

Recent Developments in DIP Financing

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Recent Developments in Debtor-in-Possession Financing

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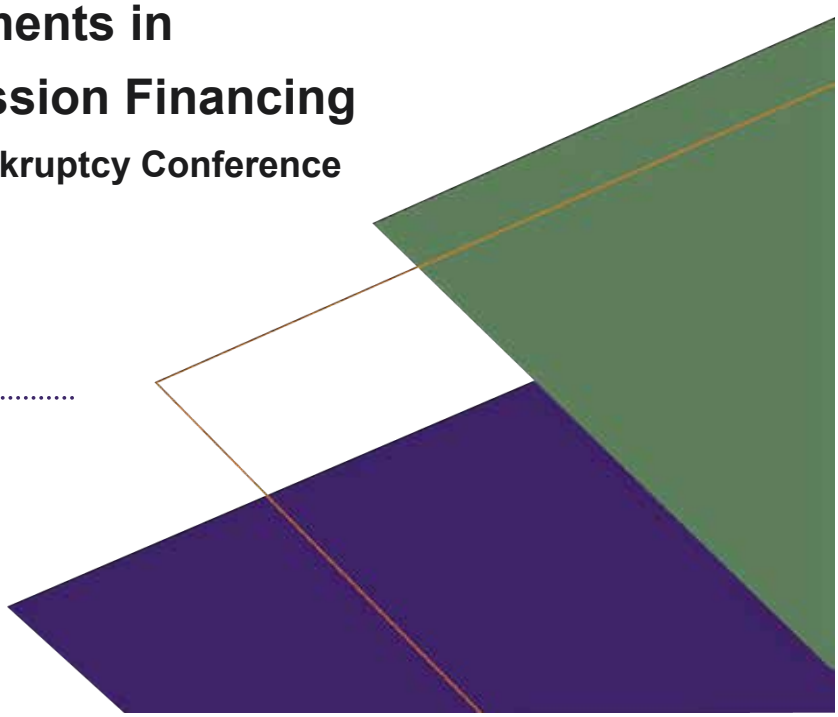

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Executive Summary

- Debtors and lenders continue to push the boundaries on what a bankruptcy court will approve in a DIP loan.
- This presentation covers the following recent trends and innovations in DIP financing:
  - The Expanding Role of DIPs in Lender-on-Lender Violence
    - DIPs Excluding Minority Lenders
    - DIPs as Step-Two in LME
  - Expansion of Permissible DIP Terms
    - Equity Conversion Features
    - Expanded Secured Lender Protections (e.g., roll-up DIPs, related issues)
    - DIP Lenders as Buyers
- This presentation also explores some potential reforms to these expansions.

Expanding Role of DIPs in Lender-on-Lender Violence: DIPs Excluding Minority Lenders

- In both the *Party City* and *Cineworld* bankruptcies, majority groups of prepetition secured lenders provided the debtors with DIP loans.
- The DIP loans in each case included a mechanisms whereby the lenders would obtain reorganized equity at a discount (e.g., backstop rights, equity conversion features).
- Certain minority lenders were not permitted into the DIP lender group and were therefore excluded from capturing these enhanced economics.
- In both cases, minority lenders objected and argued that the proposed mechanics provided the group of DIP lenders with additional windfall at the expense of the minority lenders.
  - In *Cineworld,* the minority lenders argued the ad hoc lender group had manufactured the need for a backstop by excluding other lenders. The minority lenders also noted that the terms of the backstop were discriminatory, allowing the ad hoc lender group to recover disproportionate fees by virtue of providing the backstop.
  - In *Party City,* the minority lenders argued that the disproportionate recovery obtained by the ad hoc group of first lien noteholders violated the minority lenders' right to receive *pari passu* treatment with similarly situated creditors.
- The court overruled the objection in *Party City* and the objection was settled in *Cineworld.*

Expanding Role of DIPs in Lender-on-Lender Violence: DIPs as "Step 2" of LME

- ***Step 1:*** Liability Management Transaction
- ***Step 2:*** DIP Financing from favored LME participants
  - Frequently including stringent case-control provisions, ensures protection from LME challenges.
- ***Step 3:*** Case-exit strategy devised by favored LME participants
  - Can be exit financing, equity, funded backstop, or any combination.
- Examples:
  - *GOL Linhas Aéreas Inteligentes S.A.*
  - *Wesco/Incora*

Expansion of Permissible DIP Terms: Equity Conversion Features

- *SAS AB*
  - $700 million DIP with $350 million immediately available and $350 million available upon the satisfaction of certain second draw conditions precedent in the DIP creditor agreement.
    - Cost Savings Milestones
  - Call Option: The DIP lender had the ability to convert all of a portion of its DIP loans into reorganized debtor equity under a plan based on $3.2 billion total enterprise value.
  - Tag Right: Gave the DIP lenders the right to subscribe for up to 30% of a new money equity raised with a third party on the same terms made available to the third party.
  - Termination Rights: the debtors could terminate these equity conversion features for distinct termination fees.
    - Call Option Termination Fee: $19.5 million
    - Tag Right Termination Fee: $21.0 million

- *Enviva Partners*
  - Enviva's $500 million DIP facility provided $100 million open to eligible shareholders through a subscription process. The shareholders would receive the right to convert their tranche loans to reorganized equity at a discount to plan value.
  - The official committee of unsecured creditors objected on the basis that this equity conversion made the DIP an illegal "sub rosa" plan and violated the Bankruptcy Code's absolute priority rule.
  - The Court approved the debtors' DIP over the committee's objection.

Expansion of Permissible DIP Terms: Roll Ups | *Instant Brands Acquisition Holdings, Inc.*

- Debtors and lenders have tested the limits of roll-ups in recent DIPs by seeking the ability to make large refinancing payoffs upon entry of the interim order.

- The *Instant Brands* DIP consisted of an ABL DIP facility and a Term Loan DIP facility.
  - The ABL DIP facility was a postpetition continuation and replacement of the debtors' prepetition asset-based financing program.
  - The Term Loan DIP facility provided upon entry of the interim order $132,500,000 of liquidity, of which $55,000,000 was used to pay off a prepetition equity sponsor to facilitate the release of liens and guarantees granted in a prior transaction.

- The U.S. Trustee voiced that the $55,000,000 payoff should be subject to challenge, but Judge Jones stated that he was "relatively comfortable" with the transaction in light of the "bigger picture."

Expansion of Permissible DIP Terms: Roll Ups | *Monitronics International Inc.*

- Similar to *Instant Brands*, the debtors in *Monitronics* sought approval of a $398.6 million DIP facility on an interim basis, which included an indefeasible payment of $294 million to refinance first-out exit loans from the company's prior bankruptcy. The DIP was backstopped by the ad hoc group of 2019 take-back facility lenders, who held a large portion of the first-out exit facility loans from the prior plan.

- At the first day hearing, the U.S. Trustee objected to the indefeasible payment of all $294 million and argued that it should be subject to clawback in the event of a successful challenge to the first-out exit lenders' liens pending a final DIP order. Otherwise, any such challenge would be "superfluous."

- The court approved the DIP over the U.S. Trustee's objection, but only did so after calling the DIP declarants to the stand to testify as to the necessity of having sufficient liquidity.
  - The U.S. Trustee also examined the DIP declarants who further testified that the indefeasible payment was a crucial element of the DIP and therefore the RSA.

Expansion of Permissible DIP Terms: Additional Roll-Up Issues

- Roll-ups in recent DIP financings have continued in popularity and are routinely approved, even those with relatively extreme new money to roll-up ratios.
- *Ebix, Inc.*: $105 million DIP, which included a $70 million roll-up. The Bankruptcy Court for the Northern District of Texas approved the financing over the U.S. Trustee's objection to the roll-up.
  - The U.S. Trustee had filed an objection arguing that the roll-up inappropriately grants a superpriority claim on avoidance actions, which could be a potentially valuable source of recovery for unsecured creditors.
- *Bed Bath & Beyond*: $240 million DIP, which included $40 million in new money and a $200 million rollup of prepetition FILO secured obligations (resulting in a 1:5 roll-up ratio).
  - The full amount of the DIP, both new money and the rollup, was authorized upon entry of the interim order.
- *SiO2*: $120 million DIP, consisting of $60 million in new money loans and a $60 million rollup of prepetition loans.
  - $12.4 million in new money and an equal amount of the roll-up was granted on an interim basis, with the balance of the new money and roll-ups subject to entry of a final order.
- *Acorda Therapeutics*: $60 million DIP, consisting of $20 million in new money and a $40 million rollup of prepetition notes, subject to entry of a final order.
  - The UCC filed an objection arguing, among other things, that the roll-up disadvantages the unsecured creditors and the DIP exit fee and ticking fee should not be charged against the rolled-up amounts under the DIP.
  - The debtors filed a reply stating that the terms of the DIP had been modified so that the ticking fee will not apply to the rolled-up amounts, the DIP liens will not attach to avoidance actions, and challenges to the roll-up will be preserved.
- *Vice Media*: $60 million DIP, which included $10 million in new-money and a $50 million rollup of prepetition term loans (resulting in a 1:5 roll-up ratio).

Expansion of Permissible DIP Terms: Waivers

- While not new, it is now quite commonplace for a DIP to include provisions waiving the following: (i) the right to surcharge collateral under 506(c) of the Bankruptcy Code, (ii) the rights associated with the "equities of the case" exception under 552(b) of the Bankruptcy Code, and (iii) the equitable doctrine of "marshaling."
- *Instant Brands*: Waivers of 552(b) and marshaling effective upon entry of the interim order; waiver of 506(c) subject to the final order.
- *Humanigen*: Waivers of 506(c), 552(b), and marshaling, subject to the final order.
- *Acorda Therapeutics*: Waivers of 506(c) and 552(b), subject to the final order.
  - The UCC filed an objection to final approval of the DIP arguing, among other things, that the estate waivers are inappropriate here because they have the "net effect" of limiting estate recoveries and essentially pushes the costs of liquidating secured lenders' collateral onto the unsecured creditors.
  - The debtors filed a response arguing that the waivers are common in DIPs, reflect the sound business judgment of the debtors, and "are a part of the bargain" for the debtors to obtain the DIP.
- *Diamond Sports Group*: The debtors waived all avoidance actions under section 547 of the Bankruptcy Code.
- *WeWork*: Waivers of 506(c), 552(b), and marshaling.
  - Landlords objected to the waivers, stating that the DIP budget failed to account for stub rent. The DIP should preserve the landlords' rights under existing letters of credit and limit the scope of lenders' liens on leasehold interests and the lenders' remedies in the event of default.
  - The final order established a segregated stub rent reserve and limited the lenders' ability to seek recovery from the proceeds of avoidance actions. The waivers of 506(c) and marshaling remained.

Expansion of Permissible DIP Terms: DIP Lenders as Buyers

- Balancing need for tight sale timeline with challenge period
  - *Shoes for Crews / Never Slip*
    - The debtors sought to terminate the 75-day challenge period through their bid procedures motion for the sale of all their assets and entry into a stalking horse asset purchase agreement with their DIP lender.
    - The U.S. Trustee objected and Judge Silverstein requested the shortened challenge period be pursued via a separate motion.
- DIP Lender provides financing to its own deal
  - *Sorrento Therapeutics*

Potential Reforms

- ***Increased Role of Bankruptcy Judges***
  - Pushing back on requested first day relief prior to the formation of a creditors' committee.
  - Can the market always reveal the terms of a fair DIP?
- ***Local Rules***
  - Relying on local rules allowing pushback on roll-ups.
- ***Independent Committees***
  - Increased role of independent directors and board members.

Faculty

Kathryn A. Coleman is a partner in Hughes Hubbard & Reed LLP's New York office. She has handled a wide range of chapter 11 representations and other high-stakes insolvency-related matters in her more than 35 years in practice, including dealing with "bet-the-company" litigation claims, representing acquirers in chapter 11 sale transactions, representing DIP lenders, and handling cross-border insolvency matters, out-of-court restructurings and distressed investments. Ms. Coleman's clients include individuals and companies defending trade secret theft and RICO lawsuits, publicly traded and privately held companies restructuring their financial affairs, traditional and nontraditional secured lenders, unsecured creditors (both official committees and significant creditors for their own account), equityholders, potential acquirers, equity sponsors, and financial and strategic buyers. She also is experienced in advising management and boards of directors on corporate governance, fiduciary duty and D&O insurance matters. Ms. Coleman has advised clients on, and litigated at the trial and appellate levels, the significant legal issues inherent in modern restructuring and finance practice, including contested plan confirmations, prepackaged plans, credit bidding, exclusivity, debtor-in-possession financings, valuation, adequate protection of security interests, the ability to collaterally attack orders of the bankruptcy court and cash-collateral usage. She has experience litigating venue, remand, removal and stay issues, and has represented recovery trustees dealing with myriad post-confirmation issues and litigation. Ms. Coleman is a Fellow of the American College of Bankruptcy (ACB) and serves on the board of the ACB's charitable foundation. She also serves on the ACB's Education Committee. Ms. Coleman served two terms on ABI's Board of Directors, co-chairs its annual Complex Financial Restructuring Program, and has served on the advisory boards for the annual VALCON and New York City educational programs. She frequently speaks on bankruptcy law and distressed investing, participating in programs sponsored by the Practising Law Institute, ABI, the Turnaround Management Association, AIRA, The M&A Advisor, the New York City Bar Association, the California Continuing Education of the Bar and the American Bar Association. She also serves on the Steering Committee of the NYC Bankruptcy Assistance Project. Ms. Coleman is ranked by *Chambers USA* as a leading restructuring lawyer, and she has twice been named to *Law-dragon*'s list of 500 Leading U.S. Bankruptcy & Restructuring Lawyers. She also was recognized in 2019 by *Crain's New York Business*' Notable Women in Law List for her comprehensive knowledge of insolvency law, and she was named a 2018 Bankruptcy MVP by *Law360* and as one of the 100 Most Influential Women in Business by the *San Francisco Business Times*. In addition, Ms. Coleman was designated a leading lawyer in bankruptcy in *The Best Lawyers in America*, and her experience in cross-border insolvency was noted in the *IFLR 500* and in PLC's *Cross-Border Restructuring and Insolvency Handbook*. She received her undergraduate degree *magna cum laude* from Pomona College and her J.D. from Boalt Hall School of Law (U.C. Berkeley), subsequently clerking for Hon. C. Martin Pence, U.S. District Judge for the District of Hawaii.

Robert J. Feinstein is the managing partner of the New York office of Pachulski Stang Ziehl & Jones LLP, which he opened in 2011. He represents debtors, creditors' committees, equity committees, acquirers and examiners in business reorganizations and related litigation. He also has experience representing various constituencies in cross-border chapter 11 and chapter 15 cases. Mr. Feinstein's recent engagements include lead counsel to the official creditors' committees appointed in the chapter 11 cases of J. Crew, Whiting Petroleum, Ascena Retail Group, Ditech, Jevic Transportation, The Weinstein Company,

Open Road Films, Cobalt International Energy, Bon-Ton Stores, A&P, Sports Authority, Aeropostale, AMF Bowling Worldwide, Reddy Ice Corporation, Coach Transportation and Circuit City Stores, and conflicts counsel to the creditors' committees appointed in the ResCap and Chrysler LLC cases. On the debtor side, he has represented Digital Domain Media Group, former world heavyweight champion Mike Tyson, and *Penthouse* magazine publisher General Media, Inc. in their chapter 11 cases. His cross-border representations include the Canadian receiver for Blockbuster Canada in its chapter 15 case and the Canadian monitor in the *Essar Steel* case. Mr. Feinstein is an adjunct professor in the St. Johns University LL.M. in Bankruptcy Program and an associate editor of the *Norton Journal of Bankruptcy Law and Practice*, as well as a contributing editor of *Norton Bankruptcy Law and Practice 2d*. He has authored numerous articles, and frequently lectures on bankruptcy topics. Mr. Feinstein is rated AV-Preeminent by Martindale-Hubbell, and is ranked among Bankruptcy/Restructuring attorneys by *Chambers USA*. He also has been listed in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law every year since 2018, and he was listed by *Lawdragon* as one of the 2022 "500 Leading U.S. Bankruptcy & Restructuring Lawyers" and one of the 2020 "500 Leading Global Restructuring & Insolvency Lawyers." Mr. Feinstein received his B.A. from Lafayette College and his J.D. *magna cum laude* from Boston University School of Law.

Brad M. Kahn is a partner with Akin Gump Strauss Hauer & Feld LLP in New York, where he focuses on large, complex in-court and out-of-court corporate restructurings. His experience includes representing ad hoc and official creditors' committees, as well as debtors, in high-profile chapter 11 cases. He also advises clients in multijurisdictional and cross-border insolvency proceedings. Mr. Kahn's restructuring matters encompass a variety of industries, including energy, telecommunications, shipping, technology and printing. He was listed as a *Turnarounds & Workouts* "Outstanding Young Bankruptcy Lawyer" in 2019 and as a *New York Super Lawyers* Rising Star from 2016-18. Mr. Kahn received his B.A. in 2004 from Yale University and his J.D. in 2007 from New York University School of Law.

Brett H. Miller is a partner in the Business Reorganization & Restructuring Department of Willkie Farr & Gallagher LLP in New York and chairs the firm's Official Creditors' Committees Practice Group. His clients include official and ad hoc creditors' committees, bank groups, individual lenders, court-appointed fiduciaries, debtors, and investors that focus on distressed situations. Mr. Miller advises on chapter 11 cases, out-of-court restructurings, bankruptcy-related acquisitions, cross-border insolvency matters, bankruptcy-related litigation and insolvency-sensitive transactions. Mr. Miller has represented parties in restructurings in such industries as real estate, transportation, retail, manufacturing, food service, oil and gas, and media. He is a Fellow of the American College of Bankruptcy and is listed as a leading lawyer for Bankruptcy & Restructuring in *Chambers Global*, *Chambers USA* and *Legal 500 US*. He has been recognized by *Law360* as an "MVP" of the bankruptcy bar, and *Turnarounds & Workouts* named him an "Outstanding Restructuring Lawyer." Mr. Miller received his B.A. from Columbia University in 1988 and his J.D. from Georgetown University Law Center in 1991.

Hon. John K. Sherwood is a U.S. Bankruptcy Judge for the District of New Jersey in Newark, appointed in June 2015. In private practice, he had more than 25 years of experience in bankruptcy and debtor/creditor matters, including related litigation. Some of his noteworthy engagements were Ocean Place Development Resort (counsel to debtor), MagnaChip Semiconductor Finance Co. (counsel to

creditors' committee), Quebecor World (USA) Inc. (litigation counsel), Le Nature's Inc. (counsel to creditors' committee) and the City of Detroit (counsel to union). Judge Sherwood was president of the New Jersey Bankruptcy Lawyers Foundation from 2008-13 and is an active member of ABI and the Turnaround Management Association. He was selected by *Chambers USA* from 2013-14 as one of America's Leading Lawyers for Business, and he was recognized in *The Best Lawyers in America* (2012-15) for his work in bankruptcy and in *Super Lawyers* (2006, 2009-14), where he was featured in the bankruptcy section and corporate counsel edition. Judge Sherwood received his undergraduate degree from James Madison University in 1983 and his J.D. in 1986 from Seton Hall University School of Law.

Eli Silverman is a managing director with Ducera Partners LLC in New York and has more than a decade of experience advising companies on financial restructuring, liability management, mergers and acquisitions, and debt and equity capital-raising transactions across a wide variety of industries. Prior to joining Ducera, he worked at Baird, Lazard, Z Capital Partners, Blackstone, Colony Capital and UBS. Mr. Silverman received his B.A. in economics from Duke University and his M.B.A. with a concentration in finance from Columbia Business School.

Andrew D. Sorkin is a partner in the Washington, D.C., office of Latham & Watkins and a member of the firm's Finance Department and Restructuring & Special Situations Practice. His practice focuses on chapter 11 and out-of-court restructurings, and he has represented an array of stakeholders, including debtors, creditors, shareholders, debtor-in-possession lenders, asset-purchasers, investors and professionals in restructuring matters spanning a variety of industries and sectors, including energy, telecommunications, manufacturing, oil and gas exploration, automotive and retail. Prior to joining Latham, Mr. Sorkin served as counsel in the restructuring practice at a leading international law firm. He received his B.S. in industrial and labor relations in 2004 from Cornell University and his J.D. in 2007 from the University of Virginia School of Law.