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BANKRUPTCY FINANCING – THE DEBTOR-IN-POSSESSION CREDIT ALTERNATIVE

Debtor-in-possession financing is utilized when available and necessary in chapter 11 cases, and has come to play an integral role in the restructuring process. In this article, the authors begin by discussing DIP lenders, financing structure, and issues on exit financing. They then turn to DIP financing issues and protections, including the "roll-up," waivers and releases, and credit bid rights. They close with a discussion of equity conversion rights and the complications that arise when lenders in syndicated groups do not agree.

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Distressed companies may file for relief under chapter 11 bankruptcy for many reasons but often lack sufficient liquidity to fund an in-court restructuring and therefore must obtain financial support to get through the process. The Bankruptcy Code[1] provides corporate debtors a means to obtain credit in the form of debtor-in-possession financing ("DIP" or "DIP financing").[2] DIP financing helps facilitate a successful restructuring by funding case administration and operating expenses of the debtor while the debtor seeks to restructure its debts and emerge from bankruptcy. A debtor's access to post-petition financing can provide the DIP lender with case influence in setting case milestones for property dispositions and emergence from bankruptcy, as well as other funding related covenants. The terms of DIP financing and associated orders are heavily negotiated between a debtor and its stakeholders, and can also be part of broader restructuring support negotiations in a prenegotiated or prepackaged chapter 11 case. Some recent cases have shown a trend toward prepackaged consensus among the debtor, lender, and other parties in interest regarding DIP financing and the integral role it will play in the chapter 11 restructuring process. DIP financing has become fairly common in chapter 11 bankruptcy cases. This article discusses the DIP financing tools and strategies that have been deployed in recent cases.

I. TYPES OF DIP FINANCING

A. DIP Financing Lenders

DIP financing can take on many forms depending on who the DIP lender is and their incentives. A party in

[1] "Bankruptcy Code" means Title 11 of the United States Code.

[2] Section 364 of the Bankruptcy Code authorizes a debtor to obtain DIP financing.

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the debtor's existing capital structure, a third party, or a combination thereof may step up to fund the chapter 11 process. When the DIP lender comes from the debtor's existing capital structure, it will often be comprised of some or all prepetition senior lenders, though it could also be a junior lender or an equity holder. Third parties that may step in to provide DIP financing include banks, venture capitalists, or other institutional investors. While each debtor and type of lender is unique, the willingness to provide post-petition financing can generally be boiled down to a lender's desire to preserve an existing investment in the debtor, to acquire the debtor, or for another opportunistic reason.

Legacy lenders in the existing capital structure may be motivated to provide DIP financing in an attempt to preserve the value of its prepetition collateral. Some legacy lenders may also use DIP financing to facilitate its acquisition of a debtor as part of a "loan-to-own" strategy. Under the loan-to-own strategy, the DIP loan (and potentially other secured debt) can be used to bid on assets in a sale, or to obtain assets and/or equity under a plan. A third-party, DIP-lender's incentives can be based on fees and interest to be earned, or be part of an acquisition strategy. Further, with a DIP facility comes the leverage a lender needs to obtain financial influence in the chapter 11 process, as is often the case for existing prepetition lenders.

B. DIP Financing Structure

A DIP facility may be structured as a term loan, revolving credit facility, or other form of credit. Because term loans generally are fully funded, such a structure could result in higher interest costs for the debtor. Revolving credit facilities generally have lower interest costs than a fully drawn term loan because the debtor may draw down the loan and repay only as necessary to maintain the court-approved budget. Depending on the situation, it may be appropriate for the DIP facility to be structured as a combination of both a term loan and a revolver.

The Bankruptcy Code provides protections specifically for DIP financing depending on whether the DIP loan consists of non-lien priming credit or lien priming credit. Sections 364(a) and (b) of the Bankruptcy Code permit a debtor to borrow on an unsecured basis with the DIP lender receiving a priority administrative expense claim. If the debtor is unable to obtain unsecured credit, section 364(c) of the Bankruptcy Code permits a debtor to provide a DIP lender superpriority over other administrative expenses, grant a lien on unencumbered property, and/or grant a junior lien on encumbered property. The foregoing types of non-lien priming credit are uncommon in DIP financing because arm's-length lenders are rarely willing to offer a DIP loan solely on an unsecured basis, a debtor usually lacks sufficient unencumbered property to support DIP financing, and the grant of a junior lien on encumbered property is of value only when there is equity in the encumbered property.

At the top of the Bankruptcy Code's hierarchy of protection is priming secured credit. Section 364(d) of the Bankruptcy Code allows a debtor to grant a DIP lender a priming lien in exchange for financing. A priming lien is a new lien securing a DIP loan that is senior or equal to an existing lien. To grant a priming lien, a debtor must first demonstrate that it is unable to obtain credit on less onerous terms, as well as provide adequate protection to any existing lienholder that will be primed by the DIP lender's liens. If the debtor seeks to prime existing prepetition liens with DIP liens, the debtor must either obtain consent from such preexisting lienholders or it must demonstrate that such lienholders' interest in the collateral is adequately protected. As such, prepetition lienholders are entitled to and receive "adequate protection packages" in exchange for the priming of their prepetition liens by new money DIP financing.[3] Usually, an existing lienholder will be

[3] Section 361 of the Bankruptcy Code provides that "such adequate protection may be provided by (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that . . . any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property; (2) providing to such entity an additional or replacement lien to the extent that such . . . grant results in a decrease in the value of such entity's interest in such property; or (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."

adequately protected if the debtor can make up for the decrease in the value of the lienholder's security interest either by way of a cash payment, replacement lien, and/or any other "indubitable equivalent." Note that such cash payments will likely be made periodically, as opposed to a lump sum, and may resemble interest payments. Replacement liens may be granted on avoidance actions and/or the proceeds therefrom. Lastly, while "indubitable equivalent" is not defined in the Bankruptcy Code, the provision typically operates as a catch-all and can be in the form of an equity cushion.

C. DIP Issues Related to Exit Financing

Exit financing helps pave the road to a successful restructuring by providing the reorganized debtor with funds to satisfy ongoing business obligations, including plan payments, upon emergence. Obtaining exit financing also helps reduce the amount of cash that must be raised by the reorganized debtor. A debtor can obtain exit financing through an issuance of debt from the DIP lender and/or another lender. Indeed, DIP financing can serve as a gateway for the DIP lender to provide exit financing because DIP facility terms typically require that the DIP loan is repaid in full or that the debtor provides such other treatment that is acceptable to the DIP lender before being able to confirm a plan of reorganization. In some instances, if a DIP lender is willing to provide exit financing, the lender may require full repayment of the DIP loan followed by entry into a new exit loan. Alternatively, DIP facility structures provide for an exit transaction in the form of a DIP-to-exit conversion and/or DIP-to-equity conversion. In a DIP-to-exit conversion, the debtor is given the option to convert outstanding DIP loan amounts to exit financing. In a DIP-to-equity conversion, the debtor[4] or lender[5] is given the option to convert outstanding DIP amounts to future equity in the reorganized company. Additional considerations of a DIP-to-equity conversion are discussed below.

II. DIP FINANCING ISSUES AND PROTECTIONS

A. Obtaining Approval on an Interim and Final Basis

To obtain DIP financing, the debtor must file a motion with the bankruptcy court for authorization to incur post-petition credit (the "DIP motion"). The DIP motion will typically be accompanied by the underlying DIP loan documents, affidavits/declarations in support of the DIP financing, and a proposed order (the "DIP order"). The contents of the DIP motion and/or the accompanying affidavit(s) are dictated by the Bankruptcy Rules[6] and each court's local rules, as applicable; however, generally speaking, such documents should summarize the terms of the DIP facility, the process by which the financing was obtained, the need for DIP financing, and the lack of other financing alternatives.

Because the DIP motion is often filed on the first day of a bankruptcy case, the bankruptcy court is only permitted to grant a portion of the requested relief on an interim basis, pending a final hearing.[7] That is, due to the short notice of the DIP motion to creditors and other parties in interest, the bankruptcy court will only enter an interim order authorizing the debtor to obtain DIP financing to the extent necessary to "avoid immediate and irreparable harm to the estate pending a final hearing," and subject to a court-approved budget. Immediate and irreparable harm to the estate may exist where failure or loss of business in the interim period due to lack of funds is enough to threaten the overall restructuring. Other common reasons cited by debtors to justify the immediate need for DIP financing include, among other things, the need to meet immediate and ongoing business payroll disbursements, satisfy other working capital and operational needs, and demonstrate to customers, suppliers, vendors, and employees that it has sufficient capital to continue operations and effectively reorganize. Likewise, the short notice given to creditors and other parties in interest may necessitate certain DIP lender protections (such as those discussed

[4] *In re Avianca Holdings SA*, Case No. 20-11133 (MG) (Bankr. S.D.N.Y. 2020) [Dkt No. 1031] (approving a two-tranche convertible DIP facility whereby one tranche contains an equity conversion option at the company's election if the company deems such conversion necessary after completing a market process).

[5] *In re Grupo Aeromexico, SAB de CV*, Case No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020) [Dkt. No. 29] (approving a two-tranche convertible DIP facility whereby one tranche converts to new equity at the option of the DIP lender upon satisfaction of heavily negotiated steps and conditions).

[6] Rule 4001(c) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") sets forth the substantive and procedural requirements for obtaining post-petition credit.

[7] Bankruptcy Rule 4001(c)(2) provides that "the court may commence a final hearing on a motion for authority to obtain credit no earlier than 14 days after service of the motion. If the motion so requests, the court may conduct a hearing before such 14-day period expires, but the court may authorize the obtaining of credit only to the extent necessary to avoid immediate and irreparable harm to the estate pending a final hearing."

below) set forth in the DIP order being deferred to final hearing.

B. The Roll-Up

The DIP loan amount will often consist of a new money advance only, or, if the DIP lender is the prepetition secured lender, new money plus a "roll-up" of the lender's prepetition claim. Under a roll-up, a debtor uses a portion of the DIP financing to pay all or a portion of the prepetition debt, and, as a result, such rolled-up portion is given a higher priority in payment than it would have as a prepetition secured claim. DIP roll-ups can be narrowly tailored to fit the lender's expectations of the chapter 11 case. For example, DIP lenders can use a "complete" or "set amount" roll-up whereby the DIP lender advances sufficient funds to pay the prepetition debt in full. Alternatively, the DIP lender can obtain a "creeping" roll-up whereby the proceeds of prepetition collateral received post-petition[8] are first applied to the prepetition claim and the prepetition claim is gradually rolled-up as new advances are made under the DIP facility. Regardless of the type of roll-up used, structuring a DIP facility to include a roll-up reduces a prepetition lender's risk of being subject to cram-up in a chapter 11 plan as to the rolled-up debt.

Relatedly, a DIP lender may find it advantageous to not roll-up its entire prepetition claim and instead hold a retained amount (the "retained amount") that is not primed for the purposes of potentially being an impaired accepting class[9] to facilitate cramming down dissenting voting classes in an eventual chapter 11 plan of reorganization. Thus, the retained amount can play an important role in developing and executing a viable plan of reorganization for the debtor.

While there is some ongoing debate as to whether roll-ups are consistent with the structure of the Bankruptcy Code and should be permitted at all,[10] DIP roll-ups have been increasingly used as a required component of obtaining DIP financing. When the alternative is to deny financing, the roll-up may be the only financing tool available to prevent premature and value-destroying liquidation. As such, DIP roll-ups have been approved in many bankruptcy cases.

C. Section 506(e) Surcharge Waver

Commonly, to limit risk in extending post-petition financing, a DIP lender will require that the DIP order include a waiver of surcharge claims authorized by section 506(c) of the Bankruptcy Code.[11] When a surcharge claim is charged against a secured creditor's collateral, it means that the debtor is seeking reimbursement for all costs incurred by the debtor in connection with protecting or facilitating the disposition of the creditor's collateral. That is, because such costs are seen as benefitting the secured creditor, the debtor seeks repayment thereof from the secured creditor's collateral rather than from the unencumbered assets of the debtor's estate.[12] A debtor's ability to surcharge a prepetition secured lender's collateral poses a risk that many lenders attempt to avoid with the inclusion of a surcharge waiver in the DIP order as a condition to the DIP financing.

D. Debtor Releases and Stipulations

Other protections that DIP lenders may demand before agreeing to extend DIP financing include certain releases of claims by the debtor and accompanying stipulations. The DIP order may provide for the debtor's release of defenses and claims, including claims for preferences, fraudulent conveyance, and other avoidance actions as against the DIP lender's prepetition secured claims. Depending on the circumstances, these releases may be difficult to obtain early in the case and may be more appropriate as a provision in the chapter 11 plan of

[8] Such proceeds may come from receivables and/or sales of inventory and other assets.

[9] Under section 1129(a)(10) of the Bankruptcy Code, for a plan to be confirmed, at least one impaired class must accept the plan.

[10] *Reynolds v. ServisFirst Bank (In re Stanford)*, 20-11652 (11th Cir. Nov. 1, 2021) (Jordan, J., concurring) (commenting on the conceptual similarity between roll-ups and cross-collateralization, the latter of which has been found to be "directly contrary to the fundamental priority scheme of the Bankruptcy Code" (internal quotations omitted)).

[11] Section 506(c) of the Bankruptcy Code provides that a debtor-in-possession "may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim."

[12] To impose a surcharge, a debtor must first satisfy the "consent test" or the "benefit test." The consent test is subjective, whereby the creditor caused or consented (expressly or implicitly) to bearing the fees and expenses incurred; whereas the benefit test is objective, whereby the expenses were reasonable, necessary, incurred primarily for the secured creditor's benefit, and resulted in a quantifiable direct benefit to the secured creditor.

reorganization.[13] In addition, debtors are usually required by their lenders to stipulate to certain items, including, among other things, the validity, priority, and amount of the prepetition secured claims.[14] Because a debtor's releases and stipulations are binding on the debtor and other parties upon approval of the DIP order, bankruptcy courts commonly reserve the rights of the unsecured creditors committee and other parties in interest to challenge such releases and stipulations during the "challenge period" — generally between 60 and 120 days.[15]

E. Process Terms

Process terms are often required in a DIP facility and/or through exit financing commitments. Process terms establish trigger deadlines, commonly referred to as case milestones, and operate to give the DIP lender and/or consenting secured lender significant financial influence in the chapter 11 process. Depending on the case, such process terms may contemplate DIP milestones, plan milestones, and/or asset sale milestones. For example, DIP milestones generally require the entry of an interim DIP order and final DIP order by a date certain. Likewise, plan milestones typically specify by when (1) a plan of reorganization must be filed, (2) a disclosure statement must be approved, (3) a confirmation hearing must occur, (4) a confirmation order must be entered, and (5) a plan effective date and closing transactions must occur.

DIP lenders have also included, in some cases, asset marketing and sale milestones as a condition to DIP financing to effectuate the disposition of assets to a third-party purchaser, as well as the ability to acquire assets via credit bid to the extent adequate value cannot be realized.[16] Asset sale milestones are typically tied to defined and court-approved bidding and sale procedures that set forth sale-related deadlines, such as establishing a stalking horse, when bids must be submitted, when an auction must occur, and when a sale must close.[17] Additionally, the sale process terms may require that the assets be marketed for a certain period of time.[18] This enables market testing of the assets to occur while also providing for a stable transition process of the assets if a third-party sale cannot be achieved, which is especially useful when valuation of the assets is uncertain or volatile.

Providing for process terms promotes stability and predictability during the chapter 11 process by establishing timing expectations and reducing administrative costs. However, depending on the circumstances, there is a risk of default under the DIP loan based on process timelines which could have a negative impact on the bankruptcy estate if enforced without amendment.

F. Events of Default and Remedies

Just as failure to timely perform case milestones may result in an event of default under the DIP order, other events of default may include (1) any event of default as

[13] Third-party DIP financing lenders typically have an easier time than prepetition lenders obtaining releases through the DIP order.

[14] Relatedly, a DIP lender may also commonly require that the debtor stipulate: (1) that the lender's prepetition claims are not subject to offset, defense, counterclaim, avoidance, recharacterization, or subordination; (2) to the genuineness, validity, existence, enforceability, and admissibility of prepetition claim documents; (3) that the lender's prepetition claim is secured by perfected liens and security interests in the debtor's assets; and/or (4) the debtor's current state of default under the prepetition credit agreement.

[15] The unsecured creditors' committee is oftentimes appointed, and their counsel is retained, weeks after the commencement of a bankruptcy case. Therefore, to allow them fair and sufficient amount of time to investigate the lender's liens and potential claims on behalf of the debtor's estate, the creditors' committee is typically given an extended challenge period as compared to other third parties.

[16] For an example of a process sale to third parties, *see In re Alta Mesa Resources., et al.*, Case No. 19-35133 (MI) (Bankr. S.D. Tex.) and *In re Approach Resources Inc., et al.,* Case No. 19-36444 (MI) (Bankr. S.D. Tex.). For an example of a process sale to senior lenders, *see In re Neiman Marcus Group LTD LLC, et al.,* Case No. 20-32519 (DRJ) (Bankr. S.D. Tex); *In re Nine Point Energy Holdings, Inc., et al.,* Case No. 21-10570 (MFW) (Bankr. D. Del.); *In re J.C. Penney Company, Inc., et al.,* Case No. 20-20182 (DRJ) (Bankr. S.D. Tex.); *In re Sheridan Holding Company I, LLC, et al. (Sheridan I)*, Case No. 20-31884 (DRJ) (Bankr. S.D. Tex.); *In re Sheridan Holding Company II, LLC, et al. (Sheridan II)*, Case No. 19-35198 (MI) (S.D. Tex.).

[17] The asset sale milestones will also establish a date by which the bidding and sale procedures motion must be filed and approved.

[18] Short timelines that do not take into account sufficient marketing periods could affect a "fire sale" scenario resulting in potentially lower sale prices for the estate assets — an outcome that chapter 11 seeks to avoid.

defined in the DIP credit agreement, (2) dismissal of the case, (3) appointment of a chapter 11 trustee, (4) a challenge to the DIP order, (5) failure to adhere to the court-approved budget, and/or (6) cross-default under a restructuring support agreement. The occurrence of an event of default may lead to an exercise of remedies that have negative consequences on the restructuring process. For example, the debtor's access to DIP financing may immediately terminate without further order from the bankruptcy court, usually following a default-notice period. The DIP lender may then seek to lift the automatic stay to exercise its remedies, or the DIP order may contemplate prospective relief from the automatic stay, in which case the automatic stay automatically terminates upon the debtor's default.[19] Remedies available to a DIP lender often include the right to foreclose or otherwise realize on the collateral, the right to seek specific performance, the sale of the collateral with any credit bid right remaining, and/or the right to take possession of the collateral. Note, however, that bankruptcy courts commonly reserve the right to fashion an appropriate remedy if a default occurs.

G. Section 363(k) Credit Bid Rights

To the extent a DIP lender's collateral is sold through the bankruptcy process, the right to credit bid its claim is an important protection usually provided for in the DIP order. Section 363(k) of the Bankruptcy Code provides a mechanism for a secured lender to credit bid the amount of its claim in a section 363 sale of its collateral.[20] A lender may only credit bid to the extent it has a lien that secures an allowed claim and its right to credit bid may be limited if the court orders otherwise "for cause." Cause has been found when there is a challenge to the allowance of the secured creditor's lien or certain procedural issues have occurred. A secured creditor's right to credit bid may also be limited as a result of misconduct or if the existence of such right would operate to chill the sale process or otherwise discourage prospective bidders from pursuing a sale.[21]

While the inclusion of the right to credit bid in the DIP order may be redundant, a DIP lender may require express confirmation that it is authorized to credit bid all or part of the amounts it is owed in connection with any sale or auction of the debtor's assets. Specifically, the terms for credit bidding are usually set forth in the bidding and sale procedures, and preserved in the DIP order. Such terms and procedures may contemplate a plan toggle feature that is triggered in the event the secured lender's credit bid is the highest and best bid for the debtor's assets.[22] Once the plan toggle right activates, the secured lender may opt to close the sale through a chapter 11 plan of reorganization or, if the plan is not confirmed by the deadline set forth in the case milestones and there is no extension thereof, the sale will close pursuant to section 363 of the Bankruptcy Code.

III. EXIT FINANCING AND EQUITIZATION

A. Equity Conversion Rights in DIP Financing

It is not uncommon for DIP financing transactions to include an equity conversion feature whereby the debtor or DIP lender has the option to convert outstanding amounts owed under the DIP facility to equity in the reorganized debtor (the "DIP-to-equity conversion"), which, in turn, provides the DIP lender with financial influence in the chapter 11 case and a potential equity upside upon emergence while simultaneously reducing the amount of cash that the organized debtor must raise to exit bankruptcy. The DIP-to-equity conversion can cause friction with courts because the upside received by the DIP lender can come at the expense of the unsecured creditors and other stakeholders. In fact, courts have denied DIP financing where the equity conversion feature effectively "dictate[s] the manner in which existing creditors of the bankruptcy estate are to be treated"[23] and bind the debtor to a plan structure such

[19] Bankruptcy courts generally disapprove of provisions in DIP orders that provide for automatic termination of the automatic stay upon a debtor's default under the DIP facility such that the DIP lender is not required to return to the court prior to exercising its default remedies against the debtor.

[20] Section 363(k) of the Bankruptcy Code provides: "At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder of such claim may offset such claim against the purchase price of such property."

[21] *See In re Fisker Automotive Holdings, Inc.*, 510 B.R. 55 (Bankr. D. Del 2014) (holding that the "court may deny a lender the right to credit bid in the interest of any policy advanced by the [Bankruptcy] Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment").

[22] Note that the credit bid amount is typically valued as a cash equivalent.

[23] *In re Belk Props. LLC,* 421 B.R. 221, 225 (Bankr. N.D. Miss. 2009).

that the proposed DIP financing can amount to an impermissible *sub rosa* plan.[24] Recently, however, debtors have integrated a variety of mechanics into their equity conversion rights to counteract the effects of a predetermined plan outcome, such as (1) subjecting the decision to convert to the opportunity to object and court approval and (2) a robust marketing process, as well as providing order language which specifies that despite approval of the DIP facility, any resulting plan which incorporates the equity conversion must still satisfy the requirements of section 1129 of the Bankruptcy Code.[25]

B. Emergence of Equity Fees in DIP Financing

An emerging trend in DIP financing is the treatment of DIP fees that accompany DIP loans; that is, rather than paying such fees in cash, the DIP fees are awarded as, or converted to, equity in the reorganized debtor (the "equity fee"). The business incentives are the same as those in the DIP-to-equity conversion scenario discussed above — financial influence in the chapter 11 case and a potential equity upside upon emergence for the DIP lender and a cash savings mechanism for the debtor. As such, there is also risk that the equity fee could draw an objection on *sub rosa* grounds for the same reasons discussed above. DIP lenders and debtors contemplating DIP fees consisting of equity in the reorganized debtor should consider incorporating mechanics, such as those discussed above, that will ameliorate indications of a *sub rosa* plan.

IV. WHEN LENDERS DO NOT AGREE

A. DIP Facility Non-Participants

In some cases, a debtor will seek DIP financing on a selective basis from certain prepetition lenders classified as "required lenders" or "majority lenders" under the applicable prepetition credit agreement (the "participating lenders"), as such lenders generally have the greatest amount of voting and consent rights within the lending syndicate. When the minority lenders are not offered the opportunity to participate in DIP financing (the "non-participating lenders"), participating lenders run the risk that non-participating lenders may organize and ultimately object to the DIP financing and plan of reorganization on the grounds that their non-participation amounts to unequal treatment of similarly situated creditors.[26] Moreover, because class acceptance via a plan is an important tool to effectuate results when there is less than full agreement amongst prepetition creditors, attention must be given to the relevant credit agreement with respect to voting and approval requirements amongst the lenders.

Where the participating lenders successfully negotiate a roll-up of their prepetition debt, the non-participating lenders not only lose out on the opportunity to reap the benefits associated with such roll-up (i.e., elevated priority of the their prepetition debt from secured status to superpriority administrative status), but their

[24] *In re Latam Airlines Grp. SA*, 620 B.R. 722, 819 (S.D.N.Y. Bankr. 2020) (denying DIP financing agreement on the grounds that the financing agreement constituted a prohibited *sub rosa* plan because it "necessarily determines plan terms giving the Debtors the right to distribute equity in the reorganized debtors to the Tranche C Lenders — at a 20% discount to plan value — that will not be subject to court review"); *see also In re Belk Props. LLC*, 421 B.R. at 225 (denying motion to approve DIP financing where DIP term sheet provided, *inter alia*, an equity conversion feature exercisable at the DIP lenders' "relatively unlimited discretion" and finding that "once the financing order is final and non-appealable, the plan of reorganization is a fait accompli, that is, it is an accomplished fact for all practical purposes"); see also, *Pension Benefit Guaranty Corp. v. Braniff Airways, Inc.* (In re Braniff Airways, Inc.) 700 F.2d 935 (5th Cir. 1983).

[25] *In re Avianca Holdings SA*, Case No. 20-11133 (MG) (Bankr. S.D.N.Y. 2020) [Dkt No. 964] (the court subjected a debtors' decision to exercise an equity conversion option to: a robust marketing process to be conducted prior to seeking plan confirmation, the court's review and approval of the process, and stakeholder and creditor constituency right to object to the decision, and further noted that even if the court approves the proposed DIP facility, the Debtors will still be required to satisfy section 1129 of the Bankruptcy Code to confirm a plan of reorganization); *see also In re Grupo Aeromexico, SAB de CV*, Case No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020) [Dkt. No. 29] (approving a two-tranche convertible DIP facility whereby one tranche converts to new equity at the option of the DIP lender upon satisfaction of heavily negotiated steps and conditions; however, the drag-along rights initially proposed by the debtors that would have allowed the DIP lender to drag minority investors along in a restructuring in the event of a conversion were amended to allow minority DIP lenders to instead choose whether it would accept stock or cash).

[26] 3 *Collier on Bankruptcy* ¶ 364.06[2] (16th 2021) (noting that the practice of roll-ups "is of questionable validity under the general bankruptcy principle favoring equal treatment of similarly situated creditors and disfavoring payment of prepetition debt outside of a reorganization plan" but conceding that where the prepetition lenders "are the only source of financing, are oversecured, and provide a significant portion of new money to the estate" the roll-up might otherwise be justified).

prepetition debt (along with any amounts retained by the participating lenders) is primed by both the new money portion of the DIP financing as well as the participating lenders' roll-up. Thus, when formulating the logistics of a roll-up, participating lenders should examine the terms of the prepetition credit agreement to evaluate whether the roll-up or the effects of the roll-up is violative of any terms therein.[27]

B. Plan Dynamics

In situations where DIP financing is offered on a selective basis and the DIP financing involves a roll-up, an additional level of complexity is added to the class voting equation because the roll-up and the retained amount, if any, can change the prepetition claim amounts and impact voting for confirmation of a plan of reorganization. Therefore, it is important to evaluate the relevant prepetition credit agreements to assess voting and approval requirements in order to obtain class acceptance and avoid any violation of the prepetition credit agreement.

Depending on the terms of the prepetition credit agreement, it may be necessary for the participating lenders to evaluate and hold an adequate retained amount to control the secured class and ensure class acceptance. If the participating lenders do not hold a retained amount, the amount of the secured claim will equal only the prepetition debt owed to the non-participating lenders on account of their prepetition loan holdings, thereby handing over all control of the class to the non-participating lenders. Thus, to avoid voting right disputes, it would be prudent for the participating lenders to hold back a retained amount.

Assuming the participating lender sets aside a retained amount, the amount of the claim will then be comprised of the participating lender's retained amount plus the prepetition debt owed to the non-participating lenders. In order to remain in control of the class and ensure class acceptance, participating lenders will want to ensure that their retained amount is large enough to capture the class vote in accordance with the terms of the prepetition credit agreement. This may also allow the participating lenders to drag along the non-participating lenders in the plan conformation process.

V. TAKEAWAYS

The various financing tools and mechanisms that have been deployed in chapter 11 cases can be key to a successfully prosecuted chapter 11 case. Debtors and DIP lenders have fashioned rational, commercial solutions via DIP financing, which allow the debtor's business to continue operating throughout a chapter 11 process. DIP facility terms can be set to strike a balance between the financing needs of the debtor and the inherent risk undertaken by the lender, whether such lender is a prepetition senior lender or a third party. A DIP lender typically has significant financial influence with the debtor, but does not control the debtor or the bankruptcy estate which is subject to supervision and determinations by the bankruptcy court. ■

[27] For example, some credit agreements contain ratable sharing provisions which generally require that any payment received by a lender on account of obligations due under a loan must be paid ratably to other lenders who may not receive the same proportional amount. By rolling up all or a portion of the participating lender's secured debt into a DIP facility, the debtor would be repaying a portion of the outstanding secured debt with proceeds from the DIP facility on a non-pro-rata basis.