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2017 Mid-Atlantic Bankruptcy Workshop

Let's Dip into the DIP Order

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“Let’s DIP into the DIP Order”

August 4, 2017

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DIP Financing/Order Overview

- Post Petition Sources of Liquidity and DIP Primer (Attachment A)
 - Critical to success (or failure) of a restructuring/bankruptcy
 - Sets the pace/timing of the bankruptcy
 - Financing structure, milestones and other key terms should align with overall goal of the restructuring to minimize disruption to the Debtors’ business(es), arguments among creditors, cost, and duration of the cases
 - DIP Motion/Order is typically first critical/complex issue before a Bankruptcy Court and can set the overall tone with the Court and other creditors
 - Goal should be to minimize extraneous issues
 - Pay attention to local rules (Attachment B)
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DIP Order Issues

- Over-reaching and broad findings of fact
- Re-stating the Bankruptcy Code 364(e)
- 506(c) waivers and liens on avoidance actions
- Roll-ups and creeping roll ups: when can you get one?
- Right to credit bid
- Setting realistic milestones
- Overly burdensome cures/penalties
- Challenge periods
- Cross-collateralization
- Releases
- Limitations on the authority of the Court or the debtor's discretion

DIP Order Issues

- Recent Case Examples (Attachment C)
 - Ameriforge
 - Unilife
 - SquareTwo Financial Services

Attachment A

DIP Financing Overview

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DIP FINANCING

Critical and Complicated

Financing Alternatives Waterfall

- Cash Collateral - § 363(c)
- Unsecured Credit - §§ 364(a), (b) and 503(c)(1)
- Superpriority Administrative Claim - § 364(c)(1)
- Lien on Unencumbered Property - § 364(c)(2)
- Junior Lien on Encumbered Property - § 364(c)(3)
- Senior Lien on Encumbered Property - § 364(d)

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Adequate Protection

- Defined under § 361
- Required where use of property results in decrease in value of entity's interest in property being used
- For example, use of cash collateral where debtor's is cash flow negative
- Cash payments - § 361(1)
- Additional or replacement lien - § 361(2)
- Other relief (except administrative claim) that provides with "indubitable equivalent" of entity's interest in property

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Cash Collateral

- What it sounds like
- Cash and cash equivalents (securities, certificates of deposit, negotiable instruments, etc.)
- Also, cash proceeds of other property, such as rent, dividends, etc.
- For example, cash payments received by debtor for post-petition sale of goods constitutes cash collateral
- If entity has a pre-petition interest in property that generates post-petition receipt of cash, that cash is the pre-petition entity's cash collateral

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Unsecured Credit - § 364(a) and (b)

- Credit provided on post-petition basis is entitled to administrative claim under section § 503(b)(1)
- Debtor's receive unsecured credit from post-petition suppliers of goods and services
- For example, trade creditors, professionals, etc.
- Virtually impossible to receive unsecured credit from lender such as bank

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Superpriority Administrative Claim - § 364(c)(1)

- Unsecured credit must be unavailable
- Creditor receives superpriority administrative claim, i.e., claim is entitled to payment ahead of other administrative claims
- Used as a back up for lender providing financing on a secured basis, i.e., collateral insufficient to pay claim in full
- Would only provide protection if source of payment of administrative claim comes from property not subject to lender's lien

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Lien on Unencumbered Property - § 364(c)(2)

- Unsecured credit must be unavailable
- Credit in exchange for superpriority administrative claim under §364(c)(1) or junior lien on encumbered property under §364(c)(3) may be available but may grant lien nonetheless
- Lien may be on either pre-petition property or post-petition property
- For example, debtor may grant lien on real property not subject to lien, regardless of whether purchased pre-petition or post-petition

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Junior Lien On Encumbered Property - § 364(c)(3)

- Unsecured credit must be unavailable
- Credit in exchange for superpriority administrative claim under § 364(c)(1) or junior lien on encumbered property under § 364(c)(2) may be available but may grant junior lien nonetheless
- Junior lien may be on either pre-petition property or post-petition property
- For example, debtor may grant junior lien on real property subject to lien, regardless of whether purchased pre-petition or post-petition

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Senior or “Priming” Lien on Encumbered Property - § 364(d)

- Unable to obtain credit any other way
- Must supply adequate protection to entity whose lien is being primed
- Debtor has burden of proof on adequate protection

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Applicable Rules

- Federal Bankruptcy Rule 4001
 - Hearing must be on at least 15 days notice
 - But, the court may authorize the use of cash collateral or incurrence of debt “as is necessary to avoid immediate and irreparable harm to the estate pending a final hearing”
 - Rule requires disclosure of a number of provisions in motion but does not forbid their approval
- SDNY and Delaware Local Rules
- Both require disclosure of specific provisions in motion (usually no time for Judge to read 100-200 page credit agreement)
- Both require inclusion of specific provisions in interim order and forbid certain provisions (i.e., no infeasible roll up)

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Important Terms

- Cross-Collateralization
- Roll-Up
- Creeping Roll-Up
- Oversecured Creditor
- Undersecured Creditor
- Carveout
- 506(c) Surcharge
- Avoidance Actions
- Challenge Period

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Cross-Collateralization

- DIP lender attempts to take security interest in previously unencumbered property to secure not only post-petition credit or as adequate protection of pre-petition secured claim
- Rather, security interest secured previously *unsecured* claims of lender
- Very similar to critical trade vendor analysis

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Roll-Up

- Payment of pre-petition debt with proceeds of post-petition credit
- Payment made in one lump sum
- Generally used where debtor has borrowed money under a term loan
- Rarely involves actual payment or reduction of pre-petition debt
- Results in entire loan being subject to applicable protections under 364(c) and/or (d)

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Creeping Rollup

- Identical to rollup except for timing and manner of payment of pre-petition debt
- Rollover occurs over time out of post-petition receipt of property
- Commonly used with revolving line of credit (“revolver”)
- In revolver, debtor has a zero balance account
- As proceeds come in they are applied to reduce debt
- As payments to 3rd parties are made they increase debt
- In creeping rollup, proceeds are applied to reduce pre-petition debt
- Payments to 3rd parties increase post-petition debt
- Generally, entire revolver is converted to post-petition debt in 2 to 6 weeks

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Oversecured Creditor

- An oversecured creditor is a creditor whose collateral is worth more than the balance of the debt
- Entitled to post-petition interest and other payments due under the contract (primarily professional fees) as part of its adequate protection
- Other than that, the creditor’s equity cushion is considered adequate protection even if its diminishing

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Undersecured Creditor

- An undersecured creditor is a creditor whose collateral is worth less than the balance of the debt
- Not entitled to post-petition interest and other payments due under the contract as part of its adequate protection
- Only entitled to adequate protection (usually additional liens known as replacement liens) to the extent that the value of the collateral is diminishing
- Not entitled to adequate protection for use of cash collateral if debtors is cash flow positive – somewhat ironic as the primary or sole reason that a debtor is cash flow positive in such a case is that it is not paying interest on its pre-petition debt

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Carveout

- A carveout is when a secured creditor allows for some of its collateral to be used to pay claims that are junior in priority
- Most commonly for two types of claims:
 - Statutory fees owed to the Office of the U.S. Trustee
 - Professional fees

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506(c) Surcharge

- Under § 506(c), the debtor can recover from a secured creditor's collateral "the reasonable, necessary costs and expenses of preserving, or disposing of" the collateral "to the extent of any benefit" to the secured creditor
- For example, if the collateral is worth \$100 on the petition date and the debtor incurs \$25 in disposing of the collateral for payment of \$120, the debtor may use \$20 of the proceeds to pay its expenses
- Note that the value of the creditor's secured claim does not increase and, if there is a delay while the debtor disposes of the collateral the secured lender is not compensated for the delay

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Avoidance Actions

- This is short hand for the causes of action under Chapter 5 of the Bankruptcy Code
- Specifically, §§544 (assertion of rights of hypothetical lien creditor); 545 (avoidance of statutory lien); 547 (preferential payment); 548 (fraudulent transfers); and 549 (unauthorized post-petition transactions)

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Challenge Period

- A period in which a party in interest or the Official Committee of Unsecured Creditors may challenge the amount of the lender's pre-petition claim as well as the extent, validity and perfection of its pre-petition liens
- If a challenge is not brought in the period or if a claim is timely brought but ultimately unsuccessful, the pre-petition claim and the security are deemed valid and may not be disputed by any party

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Attachment B

Local Rules by Jurisdictions

2017 MID-ATLANTIC BANKRUPTCY WORKSHOP

	DE	S.D.N.Y.	MD	E.D. PA.	NJ	E.D.Va.	N.D. W.Va.
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Local Rule	4001-2	4001-2	4001-4, 5	1002-4	4001-3	None	None
Amount of credit sought	X	X	X		X		
The existence of any borrowing base formula and estimated availability	X	X	X		X		
Conditions to closing or borrowing	X	X	X		X		
Budget		X	X		X		
Pricing and economic terms, including fees, lender's attorneys' fees, fees of any agent	X	X	X		X		
Effect on existing liens of relief requested	X (priming without consent)	X	X (priming without consent)	X (any priming)	X		
Carve-outs		X			X		
Cross-collateralization elevating prepetition debt to administrative expenses status or securing prepetition debt with post-petition assets	X	X	X	X	X		
Any roll-up provision	X	X	X (order must reserve the right to unwind)		X		

	DE	S.D.N.Y.	MD	E.D. PA.	NJ	E.D.Va.	N.D. W.Va.
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Limitations on operations, financing, use or sale of business		X		X (limits on discretion concerning a plan, or case administration)	X		
Limitations on lender's obligation to fund certain activities of a trustee, DIP or committee	X	X	X (limits on use of funds)				
Termination or default provisions	X	X	X		X		
Any change of control provisions		X			X		
Any requirement or deadline to sell property or file a plan		X			X		
Any provision affecting the debtor's right or ability to repay financing in full during course of the case		X		X (divesting DIP of discretion re: plan, etc.)	X (general limitation on debtor's powers or duties)		
In jointly administered cases, terms that govern joint liability of the debtors		X			X		
Any proposed use of loan proceeds to fund non-debtor affiliates		X			X		
Findings of fact that bind the estate or other parties without first giving time to object	X 60-75 days	X 60 days	X 60-75 days	X (any proposed finding must be disclosed)	X		

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	DE	S.D.N.Y.	MD	E.D. PA.	NJ	E.D.Va.	N.D. W. Va.
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506(c) waivers	X		X	X	X		
Liens on Chapter 5 Claims	X		X	X	X		
Disparate treatment of counsel for creditors' committee v. debtor with respect to a carve-out	X		X				
Proposed use of funds			X				
Identity of the Lender			X (insider)				
Provisions granting relief from stay to lender without further order of the court			X	X (automatic termination on default, conversion or appt. of trustee)	X (general limitation on debtor's powers or duties)		
Releases of pre-petition torts or breaches of contracts or waivers of avoidance actions				X	X		
Waivers of procedural requirements of foreclosure under non-bankruptcy law				X	X (general limitation on debtor's powers or duties)		
Waivers of rights to request use of cash collateral without secured party's consent triggered by default				X	X (general limitation on debtor's powers or duties)		

	DE	S.D.N.Y.	MD	E.D. PA.	NJ	E.D.Va.	N.D. W. Va.
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Repayment of post-petition credit in connection with a plan					X		
Waiver of right to incur liens that are pari passu					X		
Limitations on the court's or debtor's authority or rights					X		
Cross-collateralization					X		

Attachment C

Specific Case Examples

Specific Case Examples - Ameriforge

Case Information	Summary of DIP Package	Court's Key Issues	Resolution
<i>In re Ameriforge Group Inc. et al.</i>, Case No. 17-32660 (Bankr. S.D. Tex.) (Chief Judge David R. Jones).	Ameriforge, which is tied to oil & gas markets through its focus on pressure pumping and drilling systems, filed with a pre-packaged chapter 11 plan that provides for a debt-for-equity exchange and up to \$120 million in new capital through two exit facilities. The DIP facility was a secured super-priority postpetition credit facility in the form of a multiple-draw term loan in the aggregate principal amount of \$70 million. The DIP lenders also agreed to backstop a term loan exit facility in the aggregate principal amount of \$70 million that will be used to satisfy certain of the DIP claims.	At the first day hearing on May 2, 2017, on interim approval of the motion to approve DIP financing and an immediate draw of \$25 million, the Court expressed “heartburn” over the entire DIP facility, as opposed to any particular provisions, although the Court did note in particular that the request to immediately pay approximately \$50,000 in DIP lender fees “pushes me just to the very limit” because it “requires me to abrogate some things that I think are my responsibility to oversee.” (<i>See</i> Hr’g Tr. May 2, 2017, at 39:19-21.)	Ultimately, given the consensual nature of the case and the Court’s experience with debtors’ counsel in prior cases, the Court entered both the interim and final DIP orders as requested (Docket Nos. 60, 141), and the plan was confirmed very shortly thereafter on May 22, 2017 (Docket No. 142).

Specific Case Examples - Unilife

Case Information	Summary of DIP Package	Court's Key Issues	Resolution
<i>In re Unilife Corporation, et al., Case No. 17-10805 (Bankr. D. Del.) (Judge Laurie Selber Silverstein).</i>	Unilife, a designer and manufacturer of wearable medical injector products, filed a chapter 11 case in April 2017, with approximately \$200 million in prepetition debt, more than half of which was owed to its proposed DIP lender. The debtors sought approval of the use of approximately \$2 million in cash collateral and a DIP facility in the aggregate principal amount of \$7.5 million, \$1 million of which would be drawn upon entry of the interim order. The DIP facility did not involve a rollup and the DIP claims would not prime any existing liens other than the DIP lender's own prepetition liens, although the DIP lender would obtain a replacement lien on all of the debtors' assets and a superpriority claim as adequate protection. The debtors' other significant secured creditor supported the proposed DIP financing.	At the first day hearing on April 13, 2017, the Court had extensive questions regarding certain drafting technicalities and other issues (such as provisions that exceeded the protections available under 11 U.S.C. § 364(e) and provisions that would require turnover to the DIP lender in the event of improper payment to junior creditors before satisfaction of the DIP claims), but the Court's major recurring substantive issue involved provisions of the DIP order that the Court perceived would improperly hamstring the debtors' efforts to achieve a successful sale of their assets. For example, Paragraph 8 of the proposed interim order provided that the DIP superpriority claims would be senior to any claim for a breakup fee or expense reimbursement that may be granted in connection with a sale of the debtors' assets, which the Court believed had the potential to chill bidding and as such was inappropriate to include in an interim order and possibly even in a final order. (<i>See generally</i> Hr'g Tr. Apr. 13, 2017, at 46-47.)	The offending language in Paragraphs 8 and 12 in the proposed interim order was stricken without replacement, and Paragraph 9(d) was stricken and replaced with the following: "Nothing in this Interim Order shall be construed to deprive the DIP Lender of the right to 'credit bid' the DIP Loan Obligations pursuant to section 363(k) of the Bankruptcy Code, subject to the terms of [a prepetition intercreditor agreement]." Paragraph 31, which became Paragraph 30 in the entered interim order (Docket No. 62), was revised to provide that the debtors and the DIP lenders agreed that certain of the previously "prohibited" actions are instead additional events of default. All of these provisions remained consistent in the entered final DIP order (Docket No. 118.)

Specific Case Examples – Unilife cont.

Case Information	Summary of DIP Package	Court's Key Issues	Resolution
<i>In re Unilife Corporation, et al., Case No. 17-10805 (Bankr. D. Del.) (Judge Laurie Selber Silverstein).</i>		The Court had similar concerns in regard to the credit-bidding language in Paragraph 9(d) and the restriction in Paragraph 12 on use of DIP proceeds or collateral to pay fees to any person proposing to purchase the debtors' assets without consent of the DIP lender. (<i>Id.</i> at 49:25-53:17.) The Court also took issue with Paragraph 31, which prohibited certain actions by the debtors such as seeking entry of an order approving a sale that would not provide for full payment of the DIP claims absent the DIP lender's consent, which the Court found inappropriate when drafted as an affirmative agreement not to take certain actions, as opposed to an event of default.	Note that the Court also raised concerns about similar credit-bidding language at the first day hearing in <i>In re Panda Temple Power, LLC, et al.</i> , Case No. 17-10839 (Bankr. D. Del.) (Judge Laurie Selber Silverstein), which occurred one week after the first day hearing in <i>Unilife</i> . There, counsel to the DIP lender explained that provisions of this nature are important in light of the Third Circuit's decision in <i>In re Philadelphia Newspapers, LLC</i> , 599 F.3d 298 (3d Cir. 2010), which may be read to criticize lenders for failing to negotiate up front for their right to credit bid, including in connection with a sale under a proposed chapter 11 plan. (<i>See generally</i> Hr'g Tr. Apr. 20, 2017, at 55-57.) The entered interim and final orders (Docket Nos. 46, 116) contained the requested language as follows:

Specific Case Examples – Unilife cont.

Case Information	Summary of DIP Package	Court's Key Issues	Resolution
<i>In re Unilife Corporation, et al., Case No. 17-10805 (Bankr. D. Del.) (Judge Laurie Selber Silverstein).</i>			“Subject [in the interim order to entry of the Final Order and subject] to the terms of the DIP Documents: (i) the DIP Agent shall have the right to credit bid as part of any asset sale process and shall have the right to credit bid the full amount of the DIP Obligations during any sale of the Debtors’ assets (in whole or in part), including without limitation, sales pursuant to section 363 of the Bankruptcy Code or included as part of any restructuring plan subject to confirmation under section 1129(b)(2)(A)(ii)–(iii) of the Bankruptcy Code; and (ii) the Debtors acknowledge that the Prepetition Secured Parties shall have the right to credit bid as part of any asset sale process and shall have the right to credit bid the full amount of their respective claims, including, for the avoidance of doubt, adequate protection claims, if any, during any sale of the Debtors’ assets (in whole or in part) with respect to any asset subject to a duly perfected lien in

Specific Case Examples – Unilife cont.

Case Information	Summary of DIP Package	Court's Key Issues	Resolution
<i>In re Unilife Corporation, et al., Case No. 17-10805 (Bankr. D. Del.) (Judge Laurie Selber Silverstein).</i>			favor of the Prepetition Secured Parties as of the Petition Date, including without limitation, sales pursuant to section 363 of the Bankruptcy Code or included as part of any restructuring plan subject to confirmation under section 1129(b)(2)(A)(ii)–(iii) of the Bankruptcy Code.”

Specific Case Examples – SquareTwo Financial

Case Information	Summary of DIP Package	Court's Key Issues	Resolution
<i>In re SquareTwo Financial Services Corp., et al., Case No. 17-10659 (Bankr. S.D.N.Y.) (Judge James L. Garrity, Jr.).</i>	SquareTwo, a privately held business engaged in debt acquisition and recovery, filed a chapter 11 case on March 19, 2017, with a pre-packaged chapter 11 plan under which an investor would provide new money capital in exchange for equity in the reorganized debtors. The DIP facility consisted of a \$58,500,000 senior secured, superpriority revolving credit facility, with a roll-up of approximately \$41 million (to be treated as a creeping roll-up paid by cash collections pending entry of a final order, upon which the balance would be paid).	<p>At the first day hearing on March 21, 2017, the Court expressed concern about the proposed finding and conclusion that none of the DIP lenders would be deemed to be in control of the debtors for purposes of environmental law and explained that the Court was not making any findings in that regard, although the debtors may stipulate to it, so long as such stipulation is subject to the challenge period. (See Hr'g Tr. Mar. 21, 2017, at 73:10-74:6 (discussing proposed finding and conclusion at Paragraph (N)).)</p> <p>The Court also required revisions to the roll-up language at Paragraph 12(a) to be consistent with the Court's General Order M274, which requires provisions for the Court to unwind roll-up payments in the event there is a successful challenge. (See generally <i>id.</i> at 75-76.)</p>	The Court ultimately approved the DIP motion by final order after a contested final hearing on April 25, 2017. The Court approved the roll-up feature of the DIP facility and the grant of liens on unencumbered assets, with the exception of avoidance actions and proceeds of avoidance actions, and overruled most of the other objections that had been asserted by the committee in regard to the terms of the DIP order. (See generally Hr'g Tr. Apr. 25, 2017, at 159-160.)

Specific Case Examples – SquareTwo Financial cont.

Case Information	Summary of DIP Package	Court's Key Issues	Resolution
<i>In re SquareTwo Financial Services Corp., et al., Case No. 17-10659 (Bankr. S.D.N.Y.) (Judge James L. Garrity, Jr.).</i>		<p>The entered interim order provided: "The Prepetition First Lien Roll-Up shall be subject to this Court's right to unwind the paydown of the Revolving Loans in the event that there is a timely and successful challenge to the validity, enforceability, extent, perfection, and priority of the Prepetition First Priority Liens and the Prepetition First Lien Secured Obligations, or a determination that the Prepetition First Lien Secured Obligations were undersecured as of the Petition Date." (See Docket No. 60, at Para. 12(a)).</p> <p>Throughout the hearing, the Court also asked for various noncontroversial language tweaks to clarify that certain of the provisions were subject to entry of a final order (such as, for example, the grant of a lien on proceeds of avoidance actions).</p>	