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Valuation Strategies in Complex Chapter 11 Cases

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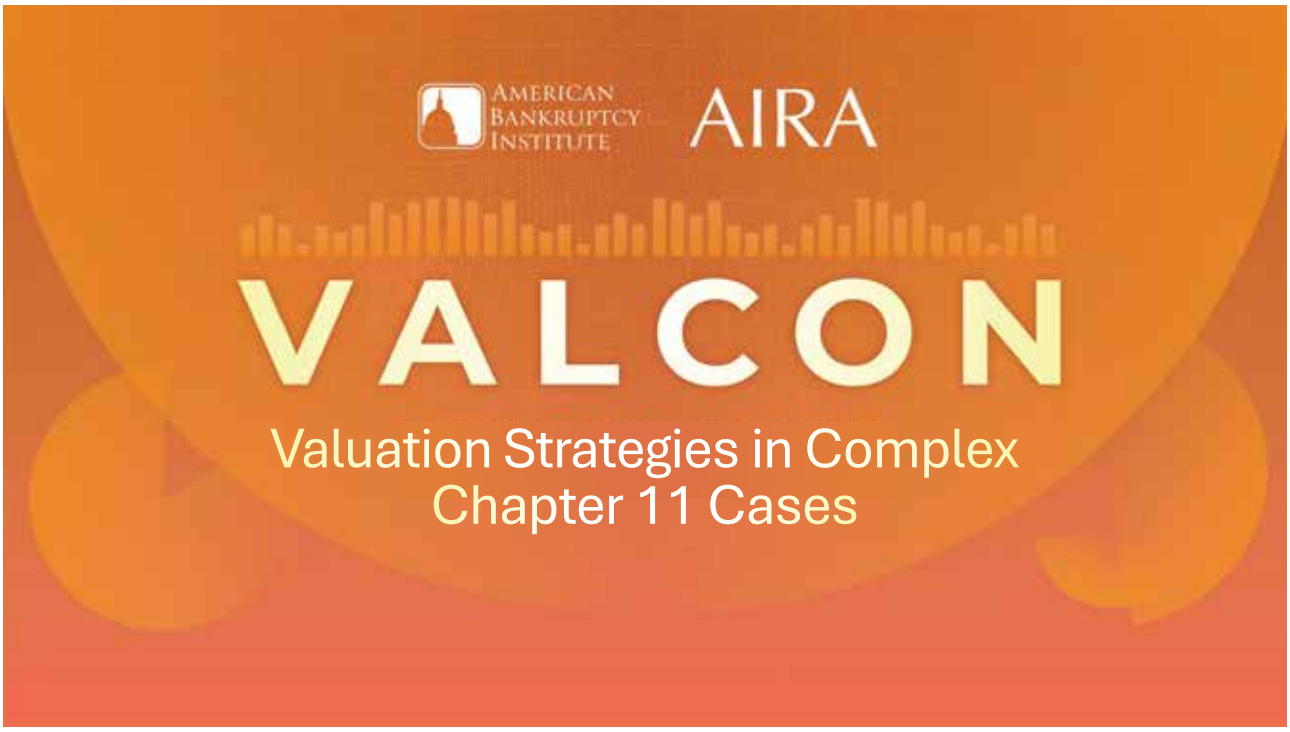

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When a debtor seeks debtor-in-possession ("DIP") financing under Section 364 of the Bankruptcy Code, the Court may authorize the incurrence of debt with **priming liens** – i.e., liens senior to existing secured creditors – if certain conditions are met. These "priming fights" often become key inflection points in the Chapter 11 case

What is a Priming Fight?

- A priming fight occurs when a debtor seeks Court approval to raise DIP financing that would be secured by liens senior to, or pari passu with, existing secured creditors' liens on already encumbered collateral – directly challenging the priority and recoveries of existing lenders
  - Priming DIP financing is typically pursued when (i) the debtor's assets are already fully encumbered and (ii) no lender will provide capital on a junior or administrative basis
- Existing lenders typically resist priming unless they are adequately protected, which often leads to litigation around collateral value and forecasted recoveries
- To authorize priming, the Court must find:
  i. The DIP financing is necessary to preserve the estate
  ii. The existing secured parties are adequately protected (e.g., through equity cushions, replacement liens, or paydowns)

Why It Matters for Valuation

- ***Priming disputes are valuation disputes.*** The crux of a priming fight is whether the value of the collateral exceeds the claims of the existing secured creditors
  - Debtors and DIP lenders argue that there is sufficient collateral value to support a new senior lien
  - Incumbent creditors may argue that collateral is fully encumbered an any priming would impair their position – forcing a direct challenge to valuation assumptions
- These disputes often lead to dueling valuation expert reports, litigation, and even evidentiary hearings

Implications for the Case

- Valuations set at this stage may become a de facto reference point for future plan negotiations or cramdown scenarios
- Sets tone for leverage in the restructuring process – if the Court sides with the debtor and approves the priming DIP, incumbent lenders may lose control over the process
- If the Court sides with the objecting creditors, it may constrain the debtor's liquidity runway or force alternative financing structures

Once a priming DIP is proposed, the burden shifts to the debtor to demonstrate that existing secured creditors are adequately protected against a decline in the value of their collateral. This becomes the first major **valuation inflection point** in a Chapter 11 case and often triggers contested hearings over asset value, future cash flows, and collateral sufficiency

Valuation as the Core Issue

- Whether a creditor is "adequately protected" hinges on a valuation of a collateral package as of the petition date
- Key question: Does sufficient value exist above the priming DIP to leave the existing lienholders no worse off?
- Requires real-time views on:
  - The **enterprise value** of the business (especially in going-concern collateral packages)
  - The **net orderly liquidation value** (NOLV) of hard assets
  - The projected **burn rate and collateral erosion** over the DIP period

Where Valuation Drives Outcomes

- **Equity Cushion Disputes:** equity cushion is the excess value of collateral / valuation buffer over the amount of a secured creditor's claim protecting them from impairment when priming is proposed
  - Creditors often argue that even minor overvaluations wipe out their cushion – undermining their protection
- **Cash Collateral Use:** when a debtor seeks to use prepetition lenders' cash collateral (e.g. A/R collections, customer deposits, etc.) it must prove such use will not diminish the creditor's secured position without adequate protection
  - Forecasts of liquidity runway and cash generation become direct valuation proxies in adequate protection debates
- **Replacement Lien Disputes:** The Court must decide whether replacement liens truly offset collateral usage – sometimes requiring asset-by-asset appraisals

Strategic Consequences

- A favorable ruling gives the debtor momentum and DIP access; an unfavorable ruling can constrain liquidity, trigger stay relief, or tee up competing plan scenarios
- Valuation credibility is established early – winning the adequate protection fight can shape creditor behavior and influence the capital structure reset

Decreased Frequency of Priming Fights

- Lack of third-party DIPs versus Incumbent DIPs
- Cost and risk associated with priming fights at the start of the case

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Cram-Ups

What is a Cram-Up?

- Occurs when a Chapter 11 plan is confirmed without the consent of a secured creditor class, typically because the debtor proposes to leave them unimpaired or reinstate their prepetition claims
  - Unlike a cramdown (which imposes terms on dissenting impaired classes), a cram-up says: "You're unimpaired—so you don't get a vote"
- Valuation is critical because cram-up feasibility hinges on whether the creditor is truly unimpaired—i.e., whether its collateral is worth enough to justify full reinstatement

Where Valuation Becomes the Fight

- Creditors argue their claims are under-secured or that their collateral is overvalued, thus entitling them to a say in the plan process while debtors push back with valuations that support reinstating the debt without modification
- A successful cram-up requires:
  - Precision in collateral appraisals
  - Evidence of ongoing business value preservation
  - Legal positioning that the creditor's rights are not being altered

Strategic Implications

- Cram-ups are a control strategy, often used to neutralize a holdout lender or prevent a fulcrum creditor from dictating plan terms
- If valuation is trending against the debtor (e.g., declining asset values, weaker operations), cram-up risks increase

Plan of Reorganization

Valuation is the foundation of plan structure:

- Determines who is in-the-money, who receives consideration, and the form of consideration (cash, debt, equity)
- Drives the classification of claims, treatment of stakeholders, and feasibility arguments

Typical Valuation Disputes at Confirmation

- Is the enterprise worth more than the secured debt?
  - Determines whether unsecureds are entitled to any recovery
- Is the plan feasible under Section 1129(a)(11)?
  - Courts test whether the reorganized business can actually deliver the forecasted value i.e. not be followed by a liquidation or further restructuring
- What is the appropriate capital structure? (not just valuation but debt capacity as well)
  - Creditors may argue the business is being over-levered post-emergence or that equity value is understated.

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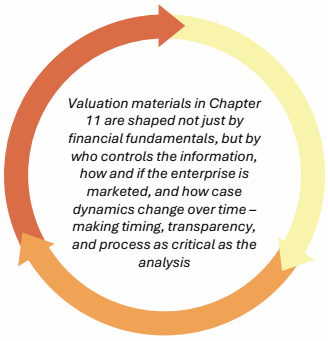
Unequal Access to Information

- Management, the DIP lender, and plan sponsors typically have real-time access to budgets, KPIs, and operational insights
- Creditors and other stakeholders often rely on lagging disclosures, redacted documents, or heavily conditioned diligence access
- This informational imbalance drives:
  - Credibility attacks on the debtor's projections
  - Disputes over methodology (e.g., DCF inputs, discount rates, cash burn forecasts)
  - Motions to compel or Rule 2004 discovery as valuation fights escalate
- Ability of the Debtor with the prudent exercise of their business judgement to revise their projections



Sale Process

- A Court-supervised marketing process becomes an external check on valuation assertions
- Sale processes can both support or undermine the Debtor's valuation assumptions
- Key valuation intersections:
  - Go-shop periods shape the "market test" argument
  - Bid structure (cash vs. credit bid) affects how recoveries map across the various claims

Case Dynamics

- Burn rate, operational shocks, or missed milestones may deteriorate the valuation story that justified DIP or early-plan terms
- Conversely, positive business momentum or third-party interest can create valuation uplift, supporting reorganized equity arguments
- Parties often use timing tactically:
  - Debtors may accelerate confirmation while projections still hold
  - Junior creditors may delay proceedings to see if things improve

Pros

- √ Forum to "Force the Issue" after negotiations fail
- √ Initial stages of the fight can lead to successful mediation once bookends have been established
- √ Rigorously tests plan feasibility
- √ Potentially draws attention to hidden and/or intrinsic value and discourages lowball bids from opportunistic investors / buyers

Cons

- x Very expensive
- x Depending on vantage point → not a level playing field
- x Distraction for the business and management team
- x Difficult to be successful on appeal

Faculty

Kizzy Jarashow is a partner in Goodwin Procter LLP's Financial Restructuring practice in New York and represents debtors, creditors, sponsors, special-situations investors and other stakeholders in all aspects of complex corporate restructurings, workouts and distressed-debt investments and acquisitions. She has represented clients in a variety of industries, including energy, retail, technology, manufacturing, health care, automotive, media, hospitality and gaming, education, financial services and real estate. She has also written extensively on restructuring-related topics, including articles published by the *Norton Journal of Bankruptcy Law and Practice*, the *ABI Journal* and ABI committee newsletters, INSOL International, and the International Bar Association's Insolvency and Restructuring International section. Ms. Jarashow is actively involved in *pro bono* matters, having worked extensively in areas of voting rights, LGBTQ+ rights and public benefits. In recognition of her work, she was selected as a Rising Star in Bankruptcy by *Super Lawyers* and is a member of the International Insolvency Institutes' NextGen Leadership Program and the National Conference of Bankruptcy Judges' Next Generation Program. Ms. Jarashow is a member of ABI and the International Women's Insolvency & Restructuring Confederation. She received her B.A. in 2004 from New York University and her J.D. *cum laude* in 2007 from Fordham University.

Lacy M. Lawrence is a partner with Akin Gump Strauss Hauer & Feld LLP in Dallas. She has handled a wide array of complex commercial litigation, including high-stakes financial restructuring and energy-related disputes and matters for telecom, real estate and accounting firm clients. Ms. Lawrence is a commercial trial lawyer who has litigated cases in state and federal courts throughout Texas and across the country. She has litigated a significant number of contested matters and adversary proceedings in U.S. bankruptcy courts. In addition, she serves on Akin's Management Committee, guiding the firm's operations worldwide and served as a member of the firmwide Diversity & Inclusion Council. Ms. Lawrence has been listed in *Chambers USA* for Litigation: General Commercial, Up and Coming for 2023-24, as a "rising Star" in 2020 in *Euromoney*'s Expert Guides, in *D Magazine* in 2019 as one of "The Best Lawyers in Dallas," and in *Texas Super Lawyers* for Civil Litigation: Defense and Business Litigation and as a "Rising Star" for 2014-20. She is a member of the American Bar Association and the State Bar of Texas, a member of the board of directors of the Dallas Urban Debate Alliance and of the Junior League of Dallas, and a Lifetime Fellow of both the Texas Bar Foundation and the Ameriucan Bar Foundation. She also served as an associate and barrister with the Patrick E. Higginbotham American Inn of Court. Ms. Lawrence received her B.A. in 2002 from Georgetown University and her J.D. in 2006 from the University of Texas School of Law.

Brian S. Lennon is a partner in Willkie Farr & Gallagher LLPs Restructuring Department in New York and chairs its Distressed Company Governance practice. He has more than 20 years of experience representing companies, boards of directors, management teams, investors, private-equity sponsors and creditors in complex transactions and litigations. Mr. Lennon often advises management teams and boards on corporate-governance matters, and he has experience achieving capital structure solutions through out-of-court transactions, including debt refinancings and exchanges, and through chapter 11 proceedings, including through prepackaged and pre-arranged chapter 11 plans. Throughout his career, Mr. Lennon has worked across a broad array of industries, including cryptocurrency, automotive, health care, technology, media, cosmetics, retail, oil and gas, coal, professional services,

and power and energy. Prior to joining Willkie in 2017, he was a partner at Kirkland & Ellis LLP. From 2013-16, he was a managing director and associate general counsel for investment manager Third Avenue Management LLC. Mr. Lennon began his career in 2003 as a law clerk to Hon. Stuart M. Bernstein, Chief Judge of the U.S. Bankruptcy Court for the Southern District of New York. He is a member of the leadership committee for Catholic Renewal, a group of professionals in the corporate restructuring industry committed to providing charitable assistance to those in need, and Brooklyn Law School's Barry L. Zaretsky Roundtable Steering Committee, a distinguished group of judges, practitioners and professors who further the scholarship and legacy of the late Professor Barry Zaretsky. Mr. Lennon received his B.A. from Vassar College in 2000 and his J.D. *cum laude* from Brooklyn Law School in 2003, where he served as notes and comments editor of the *Brooklyn Law Review* and was awarded the Zaretsky Bankruptcy and Commercial Law Fellowship.

Richard Morgner is managing director and global co-head of Debt Advisory & Restructuring at Jefferies LLC in New York, where he specializes in middle-market mergers and acquisitions, restructurings, reorganizations, and distressed M&A valuation and financial opinions. He has more than 33 years of investment banking experience, over 15 of them at Jefferies. Mr. Morgner previously spent three years at Miller Buckfire & Co. as a managing director and co-head of the firm's Mergers & Acquisitions practice, four years at Chanin Capital Partners as a managing director and head of its M&A Group, and 10 years at Prudential Securities, including as a managing director and head of its M&A Group. He has executed more than 125 advisory transactions, including debt and equity private placements, exchange offers, distressed sales, mergers and acquisitions, exclusive sales, recapitalizations, restructurings, and management and leveraged buyouts. Mr. Morgner has been qualified as a valuation expert in federal court and chairs Jefferies's Fairness Opinion/Valuation Committee. He has authorized more than 75 financial opinions/valuation reports. Mr. Morgner received his A.B. *cum laude* in history from Dartmouth College.

Daniel Moses heads Province's Institutional Creditor Advisory Business in Henderson, Nev., and has 25 years of diverse experience across distressed investing, restructuring, debt & equity capital markets and advisory services both in the U.S. and Europe. He has participated in an array of complex chapter 11 cases, in- or out-of-court restructurings, liquidations, distressed financial transactions and traditional equity investments. His expertise spans across a range of industries, including energy, financial services, gaming, health care, leisure, media, metals and mining, real estate, retail, technology and transportation. Mr. Moses's practice focuses on reorganization advisory services for secured lenders, bondholders and other creditor groups, in- or out-of-court solutions, prepackaged/prearranged chapter 11 bankruptcies and traditional chapter 11 processes. In addition, he leads Province's Financial Advisory for Independent Directors Business, which provides valuation services, board of director advisory services, pre-bankruptcy strategic alternatives and planning services, among others. Recently, he was an advisor in the cases of McDermott, WeWork, Careismatic Brands, Paratus Energy, Checkers, GWG, Nordic Aviation, Murray Energy, Guitar Center, Intelsat, Sequential Brands and Washington Prime Group, among others. Previously named #1 Distressed Analyst by *Institutional Investor* magazine, Mr. Moses is a recognized thought leader in the distressed business category. He has invested in or worked on more than 100 transactions throughout his career at such firms as Lazard Freres, DLJ, Credit Suisse, Long Acre and TPG. Prior to joining Province, Mr. Moses was the managing principal and CIO for Pacific Creek Capital, an investment firm that he built from the ground up and ran for almost a decade. He received his B.A. *magna cum laude* in American studies in 1996 from Amherst College.