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PRIVATE CREDIT RESTRUCTURING: PRIMING DIPS IN FOCUS

In most chapter 11 cases, existing first-lien lenders provide post-petition financing to preserve collateral value and maximize recovery. In some situations, a stressed borrower may threaten to pursue a hostile chapter 11 path seeking to implement a restructuring without the existing lenders' consent. In that scenario, there are threats of a "priming DIP loan." In response, the existing secured lender must assess if that threat is credible. While facts matter, in most cases, even when threatened, a priming DIP never materializes due to its many legal and structural challenges. This is particularly so where the existing lenders have validly perfected liens on substantially all assets and value indicators — usually in the form of early indications from a sale process — suggest the value of the collateral is unlikely to clear the existing lenders' secured claim. We explain our view below and the significant hurdles that a debtor must clear to thread this needle.

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PRIMING DIPS GENERALLY

Post-petition debtor-in-possession ("DIP") financing is the lifeblood of a chapter 11 case, allowing the debtor to fund its operating expenses, professional fees, and other administrative expenses incurred during the course of the case. DIP financing is necessary because, upon filing for bankruptcy, a debtor can no longer access any availability under its existing credit facilities.[1] Moreover, most debtors lack sufficient cash on hand or cash receipts from operations to fund the expense of a chapter 11 case. The Bankruptcy Code sets forth the legal standards for approving DIP financing and those standards differ depending on whether the DIP financing is secured or unsecured, and the priority of the DIP financing lien relative to existing prepetition liens. A priming DIP loan refers to financing secured by a lien that ranks senior to (or pari with) prepetition liens on the same collateral. To grant a priming DIP lien, the debtor must demonstrate that (1) it is unable to obtain financing without providing the pari or senior lien and (2) existing lienholders' interests in the collateral will be "adequately protected." 11 U.S.C. § 364(d)(1).

UNPACKING "ADEQUATE PROTECTION"

"Adequate protection" is intended to protect a pre-petition secured lender from any erosion of its interest in collateral. As Congress explained, the purpose of

[1] Bankruptcy Code § 365(e)(2)(B) provides an executory contract "to make a loan, or extend other debt financing or financial accommodation" can be terminated based on filing of the case. Bankruptcy Code § 365(c)(2) further provides the debtor cannot assume or assign an executory contract "to make a loan, or extend other debt financing or financial accommodation."

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