

Introducing the Parties to a DIP Financing

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Inherent in any debtor-in-possession financing is more complexity than a simple loan from a lender to a borrower. Numerous parties may be involved, each with different roles and interests.

Borrower/Debtor

The borrower under a DIP loan is typically a “debtor-in-possession” under Chapter 11 of the Bankruptcy Code, unless the bankruptcy court has appointed a trustee to oversee the administration of the debtor’s assets. 11 U.S.C. § 1101(1). However, even in the case of a trustee appointment, the named borrower under the loan documents technically will remain a debtor entity (even though such entity shall be under the control and direction of the trustee). It should be noted that, notwithstanding 11 U.S.C. § 1501 et al., only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under title 11. 11 U.S.C. § 109(a).

Absent compliance with foreign laws and proper filings with foreign agencies governing liens, a DIP lender most likely cannot obtain an effective lien with respect to cash residing outside of the United States (e.g., cash residing within a foreign subsidiary of a domestic debtor). Further, a bankruptcy court’s jurisdiction does not extend to foreign territories. Thus, to the extent that the debtor is the parent of foreign subsidiaries, has foreign sister entities, or maintains non-U.S.-based accounts, the DIP credit agreement may include covenants limiting cash disbursements to, and maintained within, foreign entities/foreign jurisdictions.

Guarantors

In accordance with standard market practice, each of the debtor’s direct and indirect subsidiaries typically will guaranty the debtor’s obligations under the DIP loan (though the lenders may excuse the debtor’s foreign subsidiaries from executing such guaranty to the extent that such execution would result in material incremental income tax liability under section 956 of the U.S. Internal Revenue Code of 1986).

Although typical, the guarantor need not necessarily be a subsidiary (direct or indirect) of the debtor, nor does the guarantor need to be a debtor itself. Finally, it should be noted that such guaranties typically are payment guaranties, as opposed to guaranties of collection, or “last out” guaranties, where the lender must exhaust all remedies against the debtor before seeking payment from the guarantor.

Administrative Agent and Lenders

Administrative Agent

In many instances, particularly where a credit facility involves multiple lenders, said lenders will appoint an administrative agent. The administrative agent (or an affiliate) is typically the arranger of the financing and the lender with the largest individual commitment. The administrative agent oversees the day-to-day administration of the loan, such as collecting payments due from the debtor and disbursing amounts due to the lenders. The administrative agent may have individual consent rights with respect to certain ordinary course exceptions to the terms of the DIP credit agreement sought by the debtor where the burden and cost of obtaining the approval of a majority (or all) of the lenders outweighs the benefits due to a minimal implication of such exception on the lenders’ rights.

Lenders

DIP loans may be made by a group of lenders called a “syndicate,” with the administrative agent as the lead arranger or underwriter. A DIP loan may have a syndication agent, whose role it is to identify and engage financial institutions willing to lend under the DIP credit agreement, thus further spreading the risk of borrower default among a greater number of lenders. Alternatively, a DIP loan may be “bilateral,” wherein one lender (and only one lender) simply makes a loan to the debtor.

In syndicated loans, the existence of multiple lenders creates a degree of complexity that gives rise to the need for express provisions in the credit agreement, not only with respect to the appointment, rights and duties of the administrative agent, but also with respect to the relative rights of the lenders. Such provisions address, among other things, the economic treatment of the lenders (typically several and not joint obligations with pro rata sharing of obligations and economic rights), the treatment of defaulting lenders, and the voting rights under the agreement.

With respect to voting rights, most agreements will provide that required (or requisite) lenders’ signatures are necessary to modify the credit agreement, with certain enumerated exceptions, such as changing material economic terms, which typically requires the consent of all lenders. The lenders typically have consent rights with respect to a variety of matters that directly or indirectly affect their interests. Most credit agreements (DIP or otherwise) contain a definition of “required lenders” or “requisite lenders,” which commonly means lenders holding more than 50 percent of the loans and commitments.

Expense Reimbursement

Under a typical DIP credit agreement, the debtor generally agrees to pay or reimburse: (1) the administrative agent (and, in certain instances, the lenders) for reasonable out-of-pocket costs and expenses incurred with, among other things, the preparation, negotiation and execution of the DIP credit agreement and any amendment or modification thereto, including the reasonable fees and expenses of outside counsel; and (2) the lenders for all documented out-of-pocket costs and expenses incurred in connection with, among other things, any enforcement of rights or remedies under the DIP loan documents or any “workout” of the DIP loan, including the reasonable fees and expenses of outside counsel. To the extent that the debtor fails to pay or reimburse the administrative agent for such costs and expenses, the lenders typically agree to indemnify the administrative agent for same.

Assignments and Participations

Assignments

Following the closing date of the DIP loan, each lender may assign all or a portion of its rights and obligations under the DIP credit agreement to any “eligible assignee” (as such term is defined in the respective DIP credit agreement) subject to certain restrictions set forth in the respective DIP credit agreement, including, among others, the required consent of the administrative agent to such assignment and, in certain instances, the borrower (so long as no event of default exists at the time of such assignment).

Participations

Each lender may also sell participations in the DIP loan, in some instances without the consent of, and even without notice to, the debtor or the administrative agent. It should be noted that, upon the sale of a participation, the transferring lender legally retains its rights and obligations under the DIP credit agreement and remains in contractual privity with the debtor but transfers only the economic benefits and obligations to the purchaser of the participation.

Conversely, the participant has contractual privity only with the selling lender, not with the borrower. Thus, the selling lender remains the “lender” under the credit agreement, acting as a pass-through for the economic arrangements under the loan.

Financial Advisers

In larger bankruptcy cases, each of the debtor, the administrative agent and the creditors’ committee (and often any other committee formed in a case, such as an equity committee) will most likely retain a financial adviser in order to prepare (in the case of the debtor) and review budgets, analyze financial statements and conduct due diligence. Each principal’s legal counsel typically retains the financial adviser in order to maintain all communications and work product as privileged. While the Bankruptcy Code provides for reimbursement only of the debtor’s and committees’ professional fees (including those of the respective financial advisers), the administrative agent must obtain reimbursement through the provisions of the DIP credit agreement. See 11 U.S.C. §§ 327, 330 and 1103.

Creditors’ Committee

As soon as practicable after the petition date, the trustee shall appoint a committee of unsecured creditors. See 11 U.S.C. § 1102. While not a party to the DIP credit agreement, the creditors’ committee has an opportunity to play a role in shaping the form and substance of the final DIP credit agreement. Between the dates that the bankruptcy court enters the interim order and the final order approving the DIP credit agreement, the creditors’ committee may file an objection to the proposed DIP credit agreement and/or otherwise negotiate with the debtor, secured lenders and DIP lenders with respect to the following:

1. Preserving the right of the creditors’ committee to file a motion challenging: (i) the validity, priority, or perfection of the security interests of the prepetition secured lenders; or (ii) any liability of any prepetition party with respect to anything arising from any prepetition credit facility (such motion typically to be filed within 60 days following the date of entry of the Final DIP Order);
2. Preserving (and preventing the debtor from waiving) claims under section 506(c) of the Bankruptcy Code;
3. Preventing the prepetition secured lenders and the DIP lender from obtaining a lien on any avoidance actions; and
4. Preventing cross-collateralization in the context of an “over-reaching” roll-up DIP (i.e., a DIP that results in the prepetition secured lenders having both prepetition and post-petition secured claims on the same loan.

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