**Analysis and comparison of the legislative provisions regarding DIP financing**

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# Introduction

In order for a debtor to successfully rebuild and continue their business through a corporate reorganization or restructuring procedure, a substantial amount of funds is usually required. However, debtors who have filed for bankruptcy proceedings often experience a severe deterioration in their credit, making it extremely difficult for them to obtain loans under normal circumstances.

Given these challenges, certain jurisdictions have introduced legal frameworks to provide specific protections that facilitate new borrowing after the petition, known as “debtor-in-possession financing” or “DIP financing”. This paper provides an overview of DIP financing in the United States, Singapore, and Japan as examples.

# Legislative provisions in the U.S., Singapore and Japan.

## United States

In the U.S., debtors are permitted to raise DIP financing during the pendency of their proceedings under Chapter 11 of the United States Bankruptcy Code (the “Bankruptcy Code”) and there are legislative provisions that protect DIP lenders, granting incentives for their conducting DIP financing. The measures requested are examined in sequential order, beginning with the method that has the least impact on existing creditors. As the impact on existing creditors increases, the conditions for approving the borrowing also become more stringent.

### Treating as administrative expenses

DIP may obtain unsecured credit and incur unsecured debt[[1]](#footnote-1) and DIP loans are treated as an administrative expense and afforded a higher priority than unsecured pre-petition claims[[2]](#footnote-2).

However, if the debtor is unable to repay the DIP loans with unencumbered assets, the lender may not be able to recover the loan. Therefore, this provision alone is often considered insufficient as an incentive for DIP lenders[[3]](#footnote-3).

### Super priority and other protections

Therefore, Bankruptcy Code provides that if DIP is unable to obtain unsecured credit, the court, after a notice and hearing, may authorize the obtaining of credit or the incurring of debt, through one of the following methods[[4]](#footnote-4):

(a) with priority over all administrative expenses;

(b) secured by a lien on property of the estate that is not otherwise subject to a lien; or

(c) secured by a junior lien on property of the estate that is subject to a lien.

The borrowing described in (a) above is referred to as "Super Priority" as it takes priority over administrative expenses.

With being granted a super-priority and establishing collateral for unsecured assets, as well as setting junior liens on assets already secured, the likelihood of recovery for DIP loan lenders becomes higher compared to just treating DIP loans as administrative expenses. However, if existing liens are already in place on the all or the vast majority of debtor’s assets, these methods may not give sufficient incentive for DIP lenders.

### Priming Lien

If even Super Priority does not allow for borrowing, the Bankruptcy Codes provides that the trustee may be granted more powerful means to obtain new borrowing by providing a priority lien called “Priming Liens”, which surpasses existing liens.

Specifically, the court, after notice and a hearing, may authorize the granting of a priority lien that is superior or equal in priority to existing lien on property of the estate if both of the following requirements are satisfied[[5]](#footnote-5):

1. the trustee is unable to obtain such credit otherwise; and
2. there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.

Priming liens significantly infringe upon the rights of existing secured creditors, so "adequate protection".

"Adequate protection" means that one of the following measures should be taken to compensate for the decrease in the value of the interest of an entity in a property[[6]](#footnote-6):

1. a cash payment or periodic cash payments;
2. provision of additional or replacement lien; or
3. other relief, as will result in the realization of the indubitable equivalent of such entity’s interest in such property.

### Other measures

In practice, there are other strong measures that are not explicitly authorized under the Bankruptcy Code and thus have been controversial.

1. Roll-ups

Roll-ups include the application of proceeds of post-petition financing to pay, in whole or in part, prepetition debt.[[7]](#footnote-7) This allows the lender to convert their pre-petition claims into post-petition claims and have stronger protections such as being treated as an administrative expense.

Since roll-ups substantially prioritize pre-petition claims and thus may harm other pre-petition creditors, there has been controversy over whether roll-ups should be permitted. Despite such disputes, roll-ups are not uncommon in practice. In 2020, about 37% of all DIP Loans contained a roll-up component, which accounted for 55% in value of the 2020 DIP Loan market[[8]](#footnote-8).

In practice, non-consensual priming liens are rare, as debtors usually cannot provide pre-petition secured lenders with adequate protection because of a lack of unencumbered cash flow and assets. [[9]](#footnote-9)

1. Cross-collateralization

Cross-collateralization involves the debtor granting an existing pre-petition lender a security interest in assets acquired after its bankruptcy, to secure both pre-petition and post-petition debt. [[10]](#footnote-10)

Notwithstanding the controversy around cross-collateralized DIP Loans[[11]](#footnote-11), many bankruptcy courts continue to approve them and in doing so will often consider various factors, like whether the pre-petition secured lender is over-secured. And if so, by how much and whether it remain over-secured or is its collateral is deteriorating.[[12]](#footnote-12)

## Singapore

Singapore was one of the first common law jurisdictions to legislate the protection of DIP financing. More specifically, in 2017, statutory provisions for rescue financing were introduced in Singapore’s judicial management and creditor scheme of arrangement regimes, which, combined with other amendments, making it “the first common law system in the world to introduce a unique hybrid regime combining the flexibility of the English regime with the powerful arsenal of US Chapter 11 provisions”[[13]](#footnote-13),[[14]](#footnote-14)

### Newly introduced provisions for DIP financing

The rescue financing provisions are contained at section 67 (for creditor schemes) and section 101 (for judicial management) of the Insolvency, Restructuring & Dissolution Act 2018 (IRDA).[[15]](#footnote-15) These provisions are to provide “super priority” for rescue financing[[16]](#footnote-16) and similar to Chapter 11 provisions.

Where a company has applied for leave to convene a scheme meeting or applied for a scheme moratorium, or at any time when the company is in judicial management, the court may make one or more of the following orders in respect of debt arising from rescue financing obtained by the company: [[17]](#footnote-17)

1. that the rescue debt be treated as if it were part of the costs and expenses of winding up; [[18]](#footnote-18)
2. that if the company is wound up, the rescue debt is to have priority over all the preferential debts in a winding up and all other unsecured debts; [[19]](#footnote-19),[[20]](#footnote-20)
3. that the rescue debt be secured by (a) a security interest on property of the company that is not otherwise subject to any security interest; or (b) a subordinate security interest on property of the company that is subject to an existing interest;[[21]](#footnote-21)
4. that the rescue debt be secured by a security interest, on property of the company that is subject to an existing security interest, of the same priority as or a higher priority than that existing security interest.[[22]](#footnote-22)

The protections of (b) through (d) are only available if the company would not have been able to obtain the rescue financing from any person unless the rescue debt is given such priority.

The protection of (d) is referred to as a “priming lien” and there must be “adequate protection” for the interests of the holder of that existing security interest. The IRDA provides “adequate protection” exists in the case of: [[23]](#footnote-23),[[24]](#footnote-24)

* cash payments sufficient to compensate the holder for any decrease in the value of its existing security interest;
* provision of additional or replacement security of a value sufficient to compensate the security holder for any decrease in the value of its existing security interest; or
* the court’s relief (other than compensation) that will result in the realisation by the security-holder of the indubitable equivalent of the security-holder’s existing security interest.

The language of section 361 of the US Bankruptcy Code (“*When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by —...*”) was not fully adapted in Singapore, which raises an issue as to whether the Singapore provisions leave scope for the “adequate protection” requirement to be fulfilled by other means, apart from the three expressly set out under sections 67(6) and 101(7) of the IRDA.

### Other measures

1. Roll-ups

The Singapore Courts have been clear that the “roll-ups” are not disqualified from being considered as rescue financing for the purposes of section 67 and 101 of the IRDA.[[25]](#footnote-25) The court in Design Studio[[26]](#footnote-26), however, emphasized that the use of roll-ups is not without limits and the rescue financing must create "new value”.[[27]](#footnote-27)

1. Cross-collateralization

It seems that the Singapore Courts have not been clear on whether cross-collateralization should be permitted, but there is a view that the court would most likely be willing to grant cross-collateralizations, given its similarity to debt roll-ups.[[28]](#footnote-28)

## Japan

In Japan, the process of obtaining new loans following bankruptcy is governed by the Civil Rehabilitation Law and the Corporate Reorganization Act. These legal frameworks allow debtor companies to secure post-petition financing through court approval. These loans have a higher priority than unsecured claims, which are classified as "Common Benefit Claims." This concept is similar to treating them as administrative expenses in the United States and Singapore.

However, unlike the United States and Singapore, Japan lacks additional legislative provisions that facilitate debtor access to financing during insolvency proceedings, such as priming liens and super priority. Therefore, these loans hold the same priority as other Common Benefit Claims holders and may carry the risk of loss for DIP lenders if the proceedings are converted into bankruptcy proceedings.

As a result, there has been a discussion more than 20 years regarding the introduction of new legislative provisions to further protect DIP loans. However, there have been many opposing views deeming it inconsistent with established and traditional legal systems in Japan.

Nevertheless, due to declining interest rates and other factors, even mega-banks have started actively engaging in lending DIP loans[[29]](#footnote-29). Additionally, the government has recently established a legislative council to expedite discussions on the revision of collateral laws in order to facilitate funding for SMEs. Under these circumstances, there is an unprecedented growing momentum towards introducing new provisions to further protect DIP loans. Under the current promising amendment proposal, DIP financing in the Corporate Reorganization proceedings shall be treated as Common Benefit Claims and have priority over the secured claims of the “Business Growth Collateral” rights in case of the conversion into the bankruptcy proceedings. [[30]](#footnote-30)

# Comments on the market and terms etc.

## USA

In the United States, not only is the DIP Loan market established and robust, but it is flexible and highly dynamic, with courts having approved a variety of lending arrangements[[31]](#footnote-31). In 2020, there were final DIP commitments of $23.7 billion across all sectors, according to Reorg Research’s DIP Database, which features DIP loans sized at $1 million and above[[32]](#footnote-32).

Lenders are often willing to provide rescue financing, because from a commercial standpoint, there are preferred rates and fees on DIP Loans that are typically well above the non-distress market[[33]](#footnote-33). While terms of DIP loans may vary depending on the circumstances (such as financial situation of the debtor and the power balance of the parties), the general terms are as follows[[34]](#footnote-34):

* Duration: Usually 3 years or shorter
* Repayment: Lump sum
* Funds Use: Working capital and regular use for equipment (e.g., maintenance)
* Interest Rate: Spread generally between 2.0% and 5.0% (based on LIBOR)
* Contract fees: Generally range from 0.375 to 1.0% of the unused balance
* Commission: 0.25 to 3.0%
* Priority: Super Priority Claims
* Security Interest: First priority claim on almost all assets
* Financial Covenants: Minimum EBITDA, maximum capital expenditure, Borrowing Base
* Report obligations: Weekly and monthly P/L, B/S, cash flow statements, etc.

## Singapore

There is a growing market for rescue financing in Singapore, which should, to a large extent, to be credited to the introduction of statutory provisions for rescue financing in Singapore’s judicial management and creditor scheme of arrangement regimes in 2017.[[35]](#footnote-35)

It is common for the rescue financier to require certain milestones or conditions, e.g. timelines to be met, or funds to be allocated to certain purposes. The rescue financier can influence and exercise control over the rescue process, by stipulating conditions in the granting of rescue finance[[36]](#footnote-36). The courts recognize that the decision to extend financing (and on what terms) is ultimately a commercial matter, and have clarified that the presence of conditions in the offer does not disqualify it as “rescue financing” for the purposes of section 67 and 101 of the IRDA.[[37]](#footnote-37)

## Japan

As mentioned above, in Japan, current practice treats DIP financing merely as Common Benefit claims. As a result, DIP lenders are extremely cautious about the potential conversion from the Civil Rehabilitation proceedings or Corporate Reorganization proceedings into bankruptcy proceedings following the execution of DIP financing.

Therefore, it is customary for them to secure assets with high value and liquidity, such as real estate, inventory, and accounts receivable, as collateral. Furthermore, DIP lenders carefully evaluate detailed information disclosed by the debtor, thoroughly assess the cash flow situation, and consider the likelihood of securing a sponsor. They also take into account the capabilities, experience, and reliability of the debtor's legal counsel.

As a result, DIP financing is only executed when a DIP lender identifies a very high likelihood of success in restructuring under the proceedings.

# Conclusion

This paper covered only three jurisdictions, but discussions on how to protect DIP financing are likely to continue actively in each jurisdiction. We should monitor the developments in case law and practices regarding DIP financing in each jurisdiction.

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1. DIP financing outside the ordinary course of business requires the approval of the court (section 364(b) of the Bankruptcy Code). [↑](#footnote-ref-1)
2. Section 364 (a) (b) and 503(b) of the Bankruptcy Code. [↑](#footnote-ref-2)
3. Bankruptcy and Finance Study Group, "Bankruptcy and Finance", Commercial Law Journal, Japan (2013), p 112. [↑](#footnote-ref-3)
4. Section 364(c) of the Bankruptcy Code. [↑](#footnote-ref-4)
5. Section 364(d)(1) of the Bankruptcy Code. [↑](#footnote-ref-5)
6. Section 361 of the Bankruptcy Code. [↑](#footnote-ref-6)
7. United States Bankruptcy Court Southern District of New York, In the Matter of the Adoption of Guidelines for Financing Requests (2002) [↑](#footnote-ref-7)
8. Craig Martin, “COMPARATIVE REVIEW OF APPROACHES TO "RESCUE"OR "DEBTOR-IN-POSSESSION" (DIP) FINANCE IN RESTRUCTURING AND INSOLVENCY REGIMES”, Insol International (2022), p 119. [↑](#footnote-ref-8)
9. Alan W Kornberg, Claudia R Tobler, “Restructuring & Insolvency (USA)”, LEXOLOGY, Getting The Deal Through, p 16. [↑](#footnote-ref-9)
10. Meiyen Tan, Lionel Chan, “DIP financing – the Singaporean way”, at <https://www.lexology.com/commentary/insolvency-restructuring/singapore/oon-bazul-llp/dip-financing-the-singaporean-way#loo>, accessed 6 July, 2023. [↑](#footnote-ref-10)
11. Some courts did not allow cross-collateralization. For example, *Shapiro v Saybrook Mfg Co, Inc*. 963 F. 2d at 1493 (11th Cir, 1992) held that cross-collateralization is an impermissible method or post-petition financing because it is not authorized under Section 364 and is contrary to the fundamental priority scheme of the Bankruptcy Code. [↑](#footnote-ref-11)
12. Craig Martin, op. cit., p 127 [↑](#footnote-ref-12)
13. Jo Tay, “COMPARATIVE REVIEW OF APPROACHES TO "RESCUE"OR "DEBTOR-IN-POSSESSION" (DIP) FINANCE IN RESTRUCTURING AND INSOLVENCY REGIMES”, Insol International (2022), p 91 [↑](#footnote-ref-13)
14. Indranee Rajah, “Enhancing Singapore as an International Debt Restructuring Centre for Asia and Beyond” (2017) at <https://www.mlaw.gov.sg/files/NoteonDebtRestructuring.pdf>, accessed 6 July, 2023. [↑](#footnote-ref-14)
15. Jo Tay, op. cit., p 91. [↑](#footnote-ref-15)
16. The term of “super priority” appears to have a broader meaning than the one used for the US Bankruptcy Code. [↑](#footnote-ref-16)
17. Jo Tay, op. cit., p 95. [↑](#footnote-ref-17)
18. Section 67(1)(a), 101(1)(a) read with section 203(1)(b) of the the Insolvency, Restructuring and Dissolution Act 2018 (“IRDA”). [↑](#footnote-ref-18)
19. Section 67(1)(b), 101(1)(b) read with section 203(1)(a) to (i) of the IRDA. [↑](#footnote-ref-19)
20. This concept can be said to the same as “super priority” under the Bankruptcy Code. [↑](#footnote-ref-20)
21. Section 67(1)(c), 101(1)(c) of the IRDA. [↑](#footnote-ref-21)
22. Section 67(1)(d), 101(1)(d) of the IRDA. [↑](#footnote-ref-22)
23. Section 67(6), 101(7) of the IRDA. [↑](#footnote-ref-23)
24. Jo Tay, op. cit., p 97. [↑](#footnote-ref-24)
25. Jo Tay, op. cit., p 101. [↑](#footnote-ref-25)
26. Re Design Studio Group Ltd and other matters [2020] SGHC 148. [↑](#footnote-ref-26)
27. Charles McConnell, Johann Ho, “Singapore rescue financings: introducing roll-ups”, at <https://www.whitecase.com/insight-alert/singapore-rescue-financings-introducing-roll-ups>, accessed 6 July, 2023. [↑](#footnote-ref-27)
28. Meiyen Tan, Lionel Chan, op. cit. [↑](#footnote-ref-28)
29. In the past, mega-banks were not actively engaged in DIP financing business, while relatively smaller and emerging banks were involved. One of the reasons is that DIP loan tends be small-scale and short-term, resulting in relatively low interest income, while DIP financing involves specialized credit assessments, which can be time-consuming and costly in terms of resources. [↑](#footnote-ref-29)
30. Currently, the introduction of “Business Growth Collateral rights” (i.e., all asset security or business security rights) is being considered to promote funding for SMEs. In Japan, it has been common to set collateral on individual assets, typically real estate, while setting collateral on business or all assets is very rare. However, there is ongoing consideration of legal reforms and practical changes to facilitate such collateral arrangements to make it easier for SMEs to secure funding.   
    However, concerns have been raised, particularly by insolvency practitioners, that if SMEs providing such collaterals find themselves in financial distress, access to DIP financing may become significantly challenging since they have no assets to provide as collateral. As a solution to this issue, one proposal considered is to set forth a provision that allows DIP financing to have priority over Business Growth Collateral rights under certain conditions. [↑](#footnote-ref-30)
31. Craig Martin, op. cit., p 119. [↑](#footnote-ref-31)
32. Ibid., p 119. [↑](#footnote-ref-32)
33. Ibid., p 119. [↑](#footnote-ref-33)
34. Horiuchi, Mori, Miyazaki, Yanagida, Practical aspects of workouts in the United States, Kinzai Institute for Financial Affairs, Japan (2008), p 152. [↑](#footnote-ref-34)
35. Jo Tay, op. cit., p 91. [↑](#footnote-ref-35)
36. Ibid., p 101. [↑](#footnote-ref-36)
37. Ibid., p 101. [↑](#footnote-ref-37)