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DIP-financing in the US and the UK

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TABLE OF CONTENTS

1. Introduction………………………………………………………………………………….. p. 2

2. DIP-financing in the US………………………………………………………………………. p. 3

3. DIP-financing in the UK………………………………………………………………………. p. 7

4. Comparing DIP-financing in the US and the UK …………………………………….…….. p. 9

5. Conclusion………………………………………………………………………………….... p. 10

Bibliography………………………………………………………………………………………. p. 11

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1 Introduction

1.1 The financing of companies plays a crucial role in the life cycle of these companies as well as in the development of an economy. Generally, financing may be provided either through equity finance or through debt finance. Whilst shareholders that provide equity finance are indispensable, debt finance is almost equally important to build a financially healthy capital structure. The role of debt finance becomes even more significant when companies are in financial distress. Those companies may undertake efforts to restructure and reorganise their business, but such restructuring efforts are often costly and working capital is needed to continue trading going concern. The shareholders of a company may not be able to fund all these costs and expenses. Consequently, the ability to attract rescue financing from lenders may determine the success or failure of companies in financial distress under certain circumstances.

1.2 The US Chapter 11 proceeding facilitates the debtor-in-possession (**DIP**) to attract such rescue financing from lenders throughout the proceeding. The US Bankruptcy Code provides protection to lenders through super priority and priming liens which encourages them to provide the debtor-in-possession financing (**DIP-financing**). Whilst many jurisdictions have looked at the US Chapter 11 proceeding to amend their restructuring and insolvency laws in recent years, not all of them have codified protection to lenders of DIP-financing in their laws in the same manner as the US Chapter 11 proceeding has.

1.3 Nonetheless, many companies in financial distress have successfully used other jurisdictions than the US to restructure their debt. The UK has been a forum that has been attractive for many domestic and foreign debtors (e.g., debtors from continental Europe) for many years where they used the scheme of arrangement under Part 26 of the Companies Act 2006 or the restructuring plan under Part 26a of the Companies Act 2006 to restructure their debt. In the UK, schemes and restructuring plans have facilitated restructurings through contractual amendments to intercreditor agreements that have been crammed down on dissenting (intra-class in the scheme of arrangement or cross-class in the restructuring plan) lenders.

1.4 In this paper, I will describe DIP-financing under US Chapter 11 proceeding, followed by a description of DIP-financing (or rescue financing)[1] under UK scheme of arrangement and the restructuring plan. Both jurisdictions have facilitated forms DIP-financing and have been known as jurisdictions where companies are able to successfully restructure. I will compare both legal systems to answer the following question: is it possible to reach the same result for the lenders of DIP-financing in the US and the UK, even though different legal methods are used?

1.5 In paragraph 2, I will describe DIP-financing in US Chapter 11 proceeding focusing in particular on the protection for lenders of DIP-financing in the US. The concepts of super priority and priming liens under the US Bankruptcy Code will be discussed. In paragraph 3, I will describe DIP-financing in a UK scheme of arrangement and/or restructuring plan. I will assess to what extent a similar level of protection may be reached by lenders of DIP-financing in the UK. In paragraph 4, I will compare both legal systems and the level of protection for lenders of DIP-financing. This paper will be end with a conclusion in paragraph 5.

[1] In this paper, I will use the term "DIP-financing" for consistency purposes. However, I do note that rescue financing or new financing to financial distresses companies in the UK is a different concept than DIP-financing as provided to companies in the US in a Chapter 11 proceeding. The consistent use of the term aids the legibility of this paper.

2 DIP-financing in the US

2.1 Any successful restructuring requires a well-prepared and thought-through planning. As part of the planning and preparation phase, an important question is whether the debtor has sufficient cash to continue trading going concern and for the restructuring itself. If that is not the case, external DIP-financing may be required. In practice, DIP-financing will be approved at the beginning of a US Chapter 11 proceeding so that the debtor has access to immediate cash for its ongoing working capital needs as well as the costs of the restructuring (e.g., costs of financial and legal advisors).

2.2 The lenders of DIP-financing would like to assess their legal position before they agree to granting DIP-financing. There may be various reasons for lenders to provide DIP-financing, such as high transaction fees (e.g., 4% up to 25% based on my experience in practice), high interest rates (e.g., 8% up to 18% based on my experience in practice), protecting and improving the existing position of an existing lender of the debtor, having a greater level of control during the restructuring and/or loan-to-own strategy to acquire the business. However, in this paper, the focus is solely on the legal protection of the lender of DIP-financing under a US Chapter 11 proceeding. Therefore, the main focus of this paper is on the super priority rights of a DIP-financing lender and the possibility for priming liens.

Super priority

2.3 Section 364 of the US Bankruptcy Code provides the rules for the priority of the claims under a DIP-financing. If the debtor[2] is able to obtain unsecured credit in the ordinary course of business, the claims under such credit are allowable as an administrative expense.[3] However, if the debtor is unable to obtain unsecured credit, the court may – after notice and a hearing – authorise the obtaining of credit: (i) with priority over any or all administrative expenses; (ii) secured by a lien on property of the estate that is not otherwise subject to a lien; or (iii) secured by a junior lien on property of the estate that is subject to a lien.[4]

2.4 There are two requirements that need to be satisfied to obtain court approval for such credit, namely: (i) notice and a hearing; and (ii) the inability to obtain unsecured financing. The approval of the court is acquired through a motion for authority to obtain credit before the bankruptcy court.[5]

2.5 The first requirement is notice and a hearing. As mentioned above, the debtor needs to serve a motion for authority to obtain credit which sets out a concise statement of the requested relief, the material provisions of the relevant credit agreement and a list of the parties potentially affected. Once the motion is served, often an interim hearing is scheduled within a couple of days. At this interim hearing, the court may only authorise obtaining credit to the extent necessary to avoid immediate and irreparable harm to the estate pending the final hearing.[6] The final hearing may not be held before 14 days after service of the motion. In practice, the hearing is often scheduled 21 to 30 days after the date of service of the motion.

2.6 The second requirement is that the debtor needs to establish that it was unable to obtain unsecured financing. This requirement also applies to priming liens for DIP-financing. Therefore, this requirement is discussed in more detail in paragraph 2.8 and further below.

2.7 Provided that these two requirements are met (i.e., notice and hearing and proving the inability to obtain unsecured credit), the court will give the lenders of DIP-financing some form of protection. The claims of the lenders of the DIP-financing may get super priority status: i.e., the claims of the lenders will have priority over any or all administrative expenses. As a result, these claims will have the highest ranking in bankruptcy, subject to existing liens – the only claims that rank higher are the claims of secured creditors. In addition, the DIP-financing may also be secured either (i) by a lien on property of the estate that is not otherwise subject to a lien, or (ii) by a junior lien on

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[2] The text of section 364 US Bankruptcy Code refers to the trustee, but given that most Chapter 11 proceedings are DIP-proceedings with no trustee appointed, in this paper reference is made (only) to the debtor.
[3] Section 364(a) and (b) US Bankruptcy Code.
[4] Section 364(c) US Bankruptcy Code.
[5] Rule 4001(c)(1)(A) Federal Rules of Bankruptcy Procedure.
[6] Rule 4001(c)(2) Federal Rules of Bankruptcy Procedure.

property of the estate that is already subject to a lien. Lien on property that is not otherwise subject to a lien is only possible if there are unencumbered assets. If there are any unencumbered assets left, this could be a helpful option to obtained secured DIP-financing. However, this is often difficult in practice, given that the secured lenders usually will have security over all assets of the estate. If all the assets of the debtor are already encumbered with liens of existing lenders, the DIP-financing lender may obtain a junior lien on that property. Whilst junior liens will give DIP-financing lenders a level of protection – especially when the encumbered collateral has excess value above the value of the claim of the existing secured lenders – it may be deemed insufficient by DIP-financing lenders. DIP-financing lenders may prefer a senior lien on the property, given that they are providing new money at a moment in time where the credit risk is high and the necessity for new money is also high to rescue the business. Priming liens may provide a solution here.

Priming liens

2.8 The US Bankruptcy Code also provides the option for DIP-financing with priming liens as a last resort to obtain credit. Based on the US Bankruptcy Code, the court may authorise the obtaining of credit secured by a senior or equal lien on the property of the estate that is subject to a lien only if, (i) the debtor is unable to obtain such credit otherwise, and (ii) 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.[7] The debtor has the burden of proof on the issue of adequate protection.[8] If these requirements are met, the DIP-financing lender may obtain priming liens.

2.9 As mentioned above, DIP-financing lenders will benefit from super priority claims – i.e., claims that rank with priority over any or all administrative expenses – which are claims with the highest ranking, subject to the claims of the secured lenders. The possibility for priming liens provides DIP-financing lenders for senior liens which would give them the highest ranking claims (with priority over the claims of the existing secured lenders). As a result, the DIP-financing lender will obtain security over already encumbered assets whereby the claim and, thus, the lien of the DIP-financing lender is either more senior than the lien of the existing secured lender or ranks equal to the lien of the existing secured lender. This means that the DIP-financing lender would have strong protection in bankruptcy, given that its claims rank higher over any and all other claims of secured and unsecured creditors (or, at least, equal to that of the secured creditors). However, the requirements for priming liens are not easily satisfied as such form of secured DIP-financing is a last resort. The requirements for priming DIP-financing will be discussed in more detail in the subsequent paragraphs of this paper.

2.10 Under section 364(d)(1) US Bankruptcy Code, there are two requirements for priming liens: (i) the debtor is unable to obtain such credit otherwise, and (ii) 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. Both requirements have been shaped further in case law in the US.

2.11 The first requirement is that the debtor is unable to obtain credit otherwise. *In re Beker Industries Corp.*, the court concluded that it was clear that no other lenders were willing to finance the debtor, after the debtor had approached around 35-40 lenders pre-petition and another 20 lenders post-petition.[9] Based on case law, approaching only one lending institution is not sufficient.[10] However, there is "*no duty to seek credit from every possible lender before concluding that such credit in unavailable*", given that particularly when the debtor is trying to preserve a vulnerable enterprise, time is of the essence.[11] The court must assess this requirement on a case-by-case basis taking into account all the relevant circumstances of each case, the available time and the efforts made

[7] Section 364(d)(1) US Bankruptcy Code.
[8] Section 364(d)(2) US Bankruptcy Code. See also *In re St. Petersburg Hotel Associates, Ltd., 44 B.R. 944 (Bankr.M.D.Fla. 1984).*
[9] *In re Beker Industries Corp.*, 58 B.R. 725 (Bankr. S.D.N.Y. 1986), p. 729.
[10] *In re Crouse Group, Inc.,* 71 B.R. 544 (Bankr. E.D. Pa. 1987).
[11] *In re Snowshoe Co., Inc.*, 789 F.2d 1085 (4th Cir. 1986), p. 1088.

by the debtor to obtain financing.[12] The courts have accepted two or more to be sufficient under the particular circumstances of each case, but one attempt is not sufficient.[13]

2.12 The second requirement is that there must be adequate protection for the existing secured lenders. Section 361 US Bankruptcy Code provides provisions for the concept of 'adequate protect' on. This section does not provide a definition but gives certain examples of what qualifies as adequate protection. According to section 361 US Bankruptcy Code, adequate protection may be provided by: (i) requiring a (periodic) cash payment(s) to the lender to the extent that the priming lien under section 364 US Bankruptcy code results in a decrease in the value of such lender's interest in such property; (ii) providing the lender additional or replacement lien to the extent that the granting of priming lien results in a decrease of such lender's interest in such property; or (iii) granting such other relief as will result in the realisation by such lender of the indubitable equivalent of such lender's interest in such property.

2.13 The examples given in section 361 US Bankruptcy Code are, however, not exhaustive. The meaning of 'adequate protection' needs to be determined in practice and by case law. *In re Alyucan Interstate Corp.* sets this out clearly:[14]

> "*Adequate protection is not defined in the [US Bankruptcy] Code. This omission was probably deliberate. Congress was aware of the turbulent rivalry of interests in reorganization. It needed a concept which would mediate polarities. But a carefully calibrated concept, subject to a brittle construction, could not accommodate the "infinite number of variations possible in dealings between debtors and creditors." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 339 (1977), U.S. Code Cong. Admin. News 1978, p. 5787, 6295. This problem required, not a formula, but a calculus, open-textured, pliant, and versatile, adaptable to "new ideas" which are "continually being implemented in this field" and to "varying circumstances and changing modes of financing." Id. Adequate protection was requisitioned to meet these needs. Its meaning, therefore, is born afresh out of the "reflective equilibrium" of each decision, understood through analysis of the reorganization context and the language of Section 362(d).*"

2.14 The focus of the concept of 'adequate protection' is protection of the existing secured creditor from diminution in the value of its collateral during the reorganisation process.[15] The (periodic) payment of cash clearly serves this objective. In addition, additional or replacement lien may also satisfy this requirement. *In re Reading Tube Industries* is an example where the debtor provided the existing secured lenders such replacement lien on its current assets in order to protect them against the diminution in value of their interest. The court rules that the debtor must prove that the value of the replacement lien is greater or equal to the difference between the bank's liens on the debtor's property and the value of the liens after being primed.[16] *In re Harrow Leasing Corp.* is another example where replacement of the existing (diminished) lien was accepted, whereby a third-party guarantee was provided to the existing secured creditor.[17] This was deemed acceptable to the court and the guarantor being a third party (instead of the debtor itself) did not alter the decision of the court that this would be sufficient to approve priming DIP-financing.

2.15 The priming DIP-financing may, on balance, improve the position of all parties involved. The DIP-financing lender is given the debtor new money and this cash may allow the debtor to improve its financial position to the benefit of all stakeholders. For example, *In re 495 Central Park Avenue Corp.*, the court held that the proposed renovations that would be realised with the priming DIP-financing would lead to an increase in value of the encumbered property which would serve as 'adequate protection' for the existing secured creditors.[18] This is also relevant when there is an 'equity cushion'. The term 'equity cushion' refers to the difference between the outstanding secured debt and the value of the encumbered property. If this difference is substantial, the

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12 *In re Reading Tube Industries*, 72 B.R. 329 (Bankr. E.D. Pa. 1987), p. 332.
13 *Ibid.*, p. 332.
14 *In re Alyucan Interstate Corp.*, 12 B.R. 803 (Bankr. D. Utah 1981), p. 805.
15 *In re Beker Industries Corp.*, 58 B.R. 725 (Bankr. S.D.N.Y. 1986), p. 736.
16 *In re Reading Tube Industries*, 72 B.R. 329 (Bankr. E.D. Pa. 1987), p. 333.
17 *In re Harrow Leasing Corp.*, 35 B.R. 916 (Bankr. E.D. Pa. 1983), p. 921-922.
18 *In re 495 Central Park Avenue Corp.*, 136 B.R. 626 (Bankr. S.D.N.Y. 1992), p. 631. *Cf. In re Hubbard Power & Light*, 202 B.R. 680 (Bankr. E.D.N.Y. 1996), p. 685.

'cushion' should already adequately protect the secured creditor.[19] *In re Phoenix Steel Corp.*, the court sets out how to determine the amount that actually comprises the 'equity cushion'.[20]

2.16 Finally, the question comes up to what extent pre-petition debt could be secured with post-petition liens provided for post-petition debt under the DIP-financing. Even though this does not provide the debt with additional new cash, it may be an incentive for existing pre-petition lenders to provide new money in exchange for their ability to transform the rolled-up portion of their pre-petition debt into debt that will benefit from super priority claims and (priming) liens.[21] This is, therefore, also referred to as a 'roll-up'. The post-petition debt may be used to repay the pre-petition debt, while benefiting from super priority and (priming) liens as DIP-financing. In recent years, roll-ups have become a feature of DIP-financings that is used in practice in various Chapter 11 proceedings.[22]

[19] *In re Alyucan Interstate Corp.*, 12 B.R. 803 (Bankr. D. Utah 1981), p. 810.

[20] *In re Phoenix Steel Corp.*, 39 B.R. 218 (Bankr. D. Del. 1984).

[21] Resnick, A, and Sommer, H, *Collier Guide to Chapter 11* (2012), Chapter 2.06[1][a][b].

[22] *In re Instant Brands Acquisition Holdings Inc., et al*, No. 23-90716 (Bankr. S.D. Tex. 2023); *In re Phoenix Services Topco, LLC, et al*, No. 22-10906 (Bankr. Del. 2022); *In re Bed Bath & Beyond Inc., et al*, No. 23-13359 (VFP) (Bankr. D. N.J. 2023); *In re Yellow Corporation, et al*, No. 23-11069 (CTG) (Bankr. D. Del. 2023).

3 DIP-financing in the UK

3.1 The UK is a key jurisdiction for debt restructuring for many companies in distress across the globe. When considering the UK as a forum for restructuring, debtor either opt for a scheme of arrangement under Part 26 of the Companies Act 2006 or a restructuring plan under Part 26A of the Companies Act 2006. Unlike the US Bankruptcy Code, the Companies Act 2006 does not provide specific provisions that protect DIP-financing provided by a lender to a debtor in a scheme of arrangement or restructuring plan. There is no statutory basis for super priority or priming liens in the UK.

3.2 In practice, certain forms of DIP-financing have been provided to debtors in financial distress that used the scheme of arrangement or restructuring plan to restructure their debt. The claims of the DIP-financing lenders do no take super priority over administrative expenses and other claims. Any security granted to such lenders would not prime existing liens either. As in most jurisdictions, it is possible to create liens over unencumbered assets (if there are any) or junior liens over encumbered assets. The value hereof is, however, limited.

3.3 Lenders have, nonetheless, been able to provide financing in restructurings in the UK. One of the ways to protect their interests is through contractual changes to the finance documents. As part of the proposed amendments in the financial restructuring, the debtor and the requisite majority of its lenders may agree to changes to the waterfall in the intercreditor agreement between a debtor and its creditors. An intercreditor agreement is an agreement that sets outs the rights and obligations of the various creditors of the debtor and the debtor itself. For example, it will contain provisions on subordination of certain creditors' rights (e.g., subordination of the rights of shareholders under shareholders' loans *vis-à-vis* the rights of secured lenders under a senior facilities agreement) and enforcement of security rights (e.g., the required majority lender group that may instruct the security agent to take enforcement action).

3.4 One of the key provisions of an intercreditor agreement is the 'waterfall'-provision: i.e., a provision that sets out the ranking of claims of different creditors in respect of the distribution of enforcement proceeds after enforcement of security rights by the security agent. The parties to an intercreditor agreement may agree that the DIP-financing lender will rank above (e.g., as a super senior creditor) the existing secured lenders (e.g., senior creditors) of the debtor. Consequently, the DIP-financing lender will have some form of protection. If the requisite majority for amendments of the intercreditor agreement as per the intercreditor agreement does not agree thereto consensually, the debtor may cram down the dissenting minority using a scheme of arrangement. Further, the restructuring plan allows the court to order a cross-class cram down of dissenting creditors.[23]

3.5 English law does not mandate the absolute priority rule in the context of a scheme of arrangement or a restructuring plan (unlike the US Chapter 11 proceeding). In formal insolvency proceedings, however, a mandatory order of priority is prescribed. Furthermore, the *pari passu* principle required that creditors within each class should be treated equally between themselves. Given that there is no absolute priority rule, it is theoretically possible to impair higher-ranking creditor classes without impairing junior ranking creditor classes under a restructuring plan, but this is subject to certain safeguards. This also means that in the UK it will be for the 'in the money' creditors to decide how to share the restructuring surplus, which may result in those creditors agreeing that equity should be kept whole.[24]

3.6 Therefore, it is also in principle possible to amend waterfall provisions in intercreditor agreements under a scheme of arrangement or restructuring plan. However, the courts will assess that no creditor is worse of under the scheme respectively the restructuring plan compared to the relevant alternative. Further, the courts will assess whether they should exercise their discretion to sanction a scheme or plan, whereby they will consider: (i) whether there had been compliance with the statutory requirements; (ii) whether the classes were fairly represented and the majority acted in a *bona fide* manner; (iii) whether the plan was one which a plan creditor acting in respect

[23] Section 309G Companies Act 2006.
[24] *Re Fitness First Clubs Limited* [2023] EWHC 1699 (Ch).

of its own interests could reasonably approve; (iv) whether there was some blot or defect in the plan; and (v) whether the plan is fair.

3.7 The issue of fairness will be determined on a case-by-case basis. The court also will consider the following factors in relation to the scheme's respectively restructuring plan's fairness: (i) the overall level of support for the plan;[25] (ii) whether the restructuring surplus is fairly allocated, noting this may depart from the usual waterfall where there is good reason to do so;[26] and (iii) the source of the benefits to be received under the restructuring, for example whether it is from the assets of the debtor or from third-party funding.[27] The courts will not determine whether the presented scheme or restructuring is 'the best plan' that could be offered to creditors and/or shareholders, but will assess whether it is a plan that reasonable creditor would approve.[28] It will further assess whether it is a scheme or restructuring plan that is fair.[29]

3.8 One of the most recent and important cases on this matter is the *Adler* restructuring. In this restructuring, the German Adler group used an English restructuring plan to restructure. The English High Court initially sanctioned the restructuring plan. The restructuring involved the bond debt restructuring of six series of notes issued by the Adler group whereby all maturity dates of the series of notes were respected under the plan, except for one maturity date of one specific series of notes. The English High Court needed to deal with the question whether this resulted in a violation of the *pari passu* principle. Whilst the English High Court did restate the fundamental importance of the *pari passu* principle, it sanctioned the plan and confirmed that the usual waterfall could be varied where the court was faced with a binary decision to sanction or not sanction the plan in circumstances where that plan provided a better result for all creditors (including those whose priority was being amended).[30] However, the sanctioning decision of the English High Court was overturned in appeal by the Court of Appeal in England and Wales.[31] The Court of Appeal considered that the where there is a cross-class cram down, it will apply the horizontal comparator test (i.e., comparing the treatment of one class of creditors with another class of creditors). In such circumstances, there should only be a departure from the *pari passu* principle of equality of treatment within classes of creditors whether the departure is commercially justified (e.g., trade creditors or creditors who provide new funding). Consequently, varying the waterfall in an intercreditor agreement to give DIP-financing lenders a higher ranking is possible, but will be under greater scrutiny in case of a cross-class cram down under a restructuring plan.

3.9 Finally, the question comes up to what extent the existing claims of DIP-financing lenders may get some form of enhanced priority, also referred to as "elevation", as is the case with roll-ups in the US. In the UK, such forms of elevation have been used in practice. For example, in the *ED&F Man* restructuring, enhanced priority was extended to the existing claims of the providers of the new money and the court sanctioned the plan.[32] The Court of Appeal in the *Adler* restructuring also referred to the *ED&F Man* restructuring as stated "*that to date such cases have not been the subject of adverse argument and are likely to be highly fact sensitive. There might, for example, be no such justification for the elevation of existing debt if the opportunity to provide the new money was not in reality available on an equal and non-coercive basis to all creditors; if the new money was provided on more expensive terms than the company could have obtained in the market from third parties; or if the extent to which the existing debt was elevated was disproportionate to the extra benefits provided by the new money*".[33] Therefore, the aforementioned factors will need to be taken into consideration when considering elevation or roll-ups in the UK.

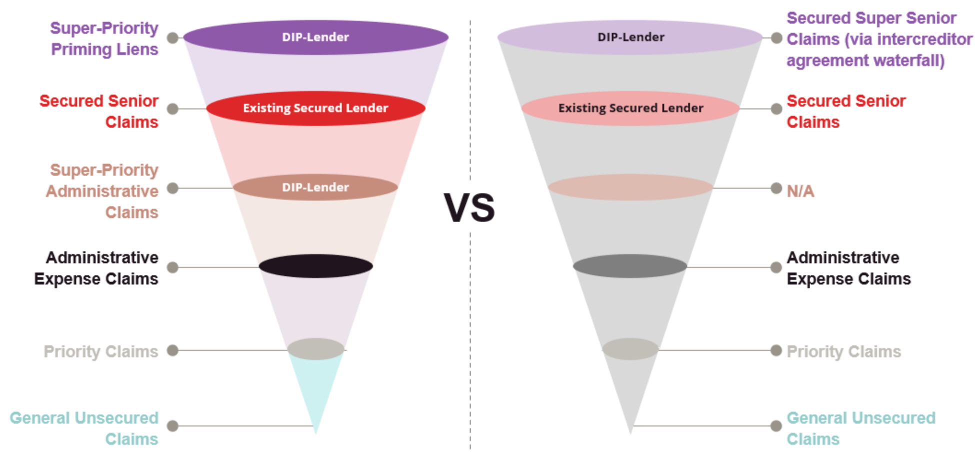
[25] *Re DeepOcean 1 UK Ltd* [2021] EWHC 138 (Ch).
[26] *Re Houst Ltd [2022]* EWHC 1941 (Ch).
[27] *Ibid.*
[28] *Re Amicus Finance plc (in administration)* [2022] Bus LR 86.
[29] *Re Prezzo Investco Limited* [2023] EWHC 1679 (Ch).
[30] *Re AGPS Bondco plc* [2023] EWHC 916 (Ch).
[31] *Re Strategic Value Capital Solutions Master Fund LP and others v AGPS BondCo PLC* [2024] EWCA Civ 24.
[32] *Re ED&F Man Holdings Limited* [2022] EWHC 687 (Ch).
[33] *Re Strategic Value Capital Solutions Master Fund LP and others v AGPS BondCo PLC* [2024] EWCA Civ 24.

4 Comparing DIP-financing in the US and the UK

4.1 In this paragraph, the forms of DIP-financing in the US and the UK will be compared. The comparison of both systems is focused on providing a functional and practical analysis. The analysis in this paragraph is not meant to serve a comparative law analysis.[34] The main purpose is to describe how both systems compare to each and what considerations would be relevant for a DIP-financing lender for preferring one jurisdiction over another.

4.2 Lenders of DIP-financing in US Chapter 11 proceedings benefit from various forms of protection. Their claims under the DIP-loan have super priority. In addition, they may benefit from priming liens. Furthermore, they may roll-up pre-petition debt as part of the DIP-financing. Lenders of DIP-financing in UK schemes of arrangement of restructuring plans, however, do not benefit from super priority nor from priming liens. They may benefit from contractual changes to the intercreditor agreement – which may be (cross-class) crammed down by the court, if need be – which would give them super senior priority over the existing secured creditors. The elevation of existing debt claims (comparable to a roll-up) is also possible under certain circumstances. Hence, while both legal systems differ significantly, the outcome may *de facto* not be too far off. The below chart provides an overview of both legal systems comparing ranking of claims.

US Chapter 11 vs. UK scheme of arrangement/restructuring plan



4.3 Furthermore, in practice often existing secured lenders of the debtor provide the DIP-financing, also to protect or improve their position in respect of their existing exposure. While in 2016 merely 15% of the DIP-financing in the US was granted by third-party lenders,[35] in 2019 only 4% of the DIP-financing in the US was granted by third-party lenders.[36] This means that existing lenders assess the risk and exposure and, from their perspective, the ability to roll-up or elevate existing pre-petition debt as well as to obtain the highest ranking security (which features are prevalent in both legal systems) will be more important than the (lack of) super-priority administrative claims (which is available in the US Chapter 11 proceedings, but not in the UK scheme of arrangement or restructuring plan).

4.4 On balance, DIP-financing lenders will have a stronger position in the US than the UK. They benefit from priming liens as well as super-priority administrative claims, given them more (voting) control over the process. In addition, they will have certainty on these protections at the beginning of the Chapter 11 proceeding. However, DIP-lenders in the UK remain dependent on the end-result as the scheme or plan needs to be sanctioned. As a result, they will face more uncertainty.

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[34] Dogmatically, a comparative law analysis requires a more in-depth analysis of each legal system before a comparison can be made. The format of this short paper for INSOL's Global Insolvency Practice Course does not provide sufficient room for an elaborate academic comparative law analysis, but is better fit for a functional and pragmatic approach.

[35] Friedman, J, et al, *Debtwire 2016 DIP Financing Report*, Restructuring Data Report, p. 8.

[36] Friedman, J, et al, *Debtwire 2019 DIP Financing Report*, Restructuring Data Report, p. 7.

5 Conclusion

5.1 In this paper, the question whether it is possible to reach the same result for the lenders of DIP-financing in the US and the UK, even though different legal methods are used, has been addressed. Whilst both legal systems provide DIP-financing lenders some level of protection of their claims as well as comparable results, there remain significant differences between them.

5.2 The US Chapter 11 proceeding and UK scheme of arrangement or restructuring plans have been used in many restructurings across the globe. One of the main benefits of the US Chapter 11 proceeding is the ability to provide DIP-financing with protection to lenders of such DIP-financing. In the US, DIP-financing lenders' claims have super priority. Further, they may obtain priming liens over already encumbered assets. In addition, it is also possible to roll-up existing pre-petition debt under the DIP-financing so that they benefit from the post-petition security. In the UK, there are no statutory provisions that deal specifically with DIP-financing. Whilst DIP-financing lenders' claims do not benefit from super priority, in practice such DIP-financing lenders have enhanced their security through contractual changes to the waterfall in the intercreditor agreement – where needed, (cross-class) crammed down by the court – to built-in some form of protection. Furthermore, elevation or roll-up of existing claims is also possible if certain requirements on fairness are met. Consequently, DIP-financing lenders benefit from protection in both legal systems.

5.3 Having said the above, the two legal systems do differ materially. Whilst DIP-financing lenders may benefit from a higher-ranking status of their claims through changes to the waterfall in the intercreditor agreement in a scheme or restructuring plan in the UK, the protection afforded to them in a US Chapter 11 proceeding goes further. It provides them super priority claim as well as priming liens. This could lead to stronger levels of (voting) control over the restructuring process. In addition, a DIP-financing is approved by the court at the beginning of a Chapter 11 proceeding. As a result, the DIP-financing lender will have certainty with respect to its position from the outset. However, a DIP-financing lender in a UK scheme of arrangement or restructuring plan needs to await the outcome of the voting and the sanctioning of the scheme respectively the plan in the UK. If the scheme respectively the plan is not sanctioned, the end-result may still be a surprise for them resulting in a lack of the level of protection of their claims as they were seeking for. Hence, there remain differences between both legal systems. From the perspective of a DIP-financing lender, the US Chapter 11 proceeding remains preferable given the level of protection as well as the legal certainty from the outset.

6 Biography

US case law

In re Alyucan Interstate Corp., 12 B.R. 803 (Bankr. D. Utah 1981)

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Author statement

Omar Salah

DECLARATION OF HONOUR:

I declare that the paper, titled “DIP-financing in the US and the UK”,

is my own work, that it has been prepared independently and that all references to, or quotations from, the work of others are fully and correctly cited.

Omar Salah..........

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