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AFFECTING LENDING AND OTHER FINANCIAL INSTITUTIONS

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## YOU'VE GOT TO FIGHT! FOR A CONTRACTUAL DIP FINANCING PARTICIPATION RIGHT

*While many loan agreements contain a “sacred right” prohibiting “Required Lenders” from effectuating new money priming financing and/or the exchange of existing loans into such priming debt on a non-pro rata basis (commonly referred to as “Serta” protection), such Serta protection often contains a carve-out for debtor-in-possession financing. This article argues that lenders (both in syndicated and private credit facilities) should fight back against such a carve-out and expressly require as a sacred right a DIP financing participation right as part of “Serta” protection (or otherwise negotiate for a contractual DIP financing participation right) to protect against the value destruction attendant in a chapter 11 case where minority lenders are not offered the right to ratably participate in DIP financing commitments arranged and provided by the majority “Required Lenders.” Such protection is especially important given the lack of protections for minority lenders under relevant bankruptcy law related to DIP financing.*

By Michael R. Handler \*

Countless ink has been spilled writing about how to mitigate the risk of value leakage for senior secured lenders and bondholders in connection with liability management exercises (“LMEs”) and other financing structures pursued by financially stressed companies. Yet, one of the biggest risks of value leakage for senior secured lenders and bondholders in a downside scenario is not having the opportunity to participate in such lender’s or bondholder’s pro rata share of debtor-in-possession (“DIP”) financing funded by an incumbent group of lenders or bondholders constituting the “Required Lenders” or “Majority Noteholders” (herein referred to as “Controlling Creditors”) in the borrower’s chapter 11 case. In sum, DIP financing can be used to effectively distribute substantially all of a minority lender’s and/or bondholder’s (hereinafter referred to as a

“Minority Creditor”) interest in collateral and enterprise value (and expected recovery) at the beginning of the chapter 11 case, and the Bankruptcy Code provides limited protections in connection therewith.

While a Minority Creditor excluded from pro rata participation in a priming DIP financing may be able to litigate its way to a participation right or change the terms of the DIP financing so that it isn’t as dilutive, the limited case law on this issue — including the U.S. Bankruptcy Court for the District of Delaware’s recent decision in the *American Tire Distributor’s* chapter 11 cases — underscores the challenges of such litigation being successful. The *American Tire Distributor* decision and other bankruptcy case law, however, suggest that bankruptcy courts will enforce — or at least

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### IN THIS ISSUE

- WHAT TO EXPECT IN BANK REGULATION IN 2025, Page 43

refrain from impairing — a contractual right relating to Minority Creditor participation in DIP financing provided by the Controlling Creditors. Thus, as set forth herein, lenders and bondholders need to fight (i.e., aggressively negotiate) for *Serta* protection that is inclusive of DIP financing or, alternatively, some other formulation of a contractual DIP financing participation right.<sup>1</sup>

Part I of this article provides a brief overview of the economics and relevant provisions in the Bankruptcy Code and common law related to DIP financing, including why such provisions leave Minority Creditors with limited recourse if Controlling Creditors exclude or limit Minority Creditors' participation in their DIP financing. Part II briefly discusses some of the relevant case law, including the *American Tire Distributors* decision, on DIP financing participation rights for Minority Creditors. Part III concludes with some recommendations on how lenders and bondholders may be able to obtain a contractual right to participate in DIP financing provided by Controlling Creditors, including a specific formulation of *Serta* protection.

## DIP FINANCING PARTICIPATION IN PROPER CONTEXT

The Bankruptcy Code provides for special protections for debtor-in-possession financing in order to incentivize lenders to provide such financing. Ironically, however, the statutory protections and other common law relief intended to incentivize reluctant lenders to participate in some circumstances incentivize Controlling Creditors from excluding or limiting the participation of Minority

Creditors. In other words, the juice is so good, it is worth the squeeze (of Minority Creditors).<sup>2</sup>

Among other things, Section 364 expressly authorizes the debtor to obtain debtor-in-possession secured by a senior “priming” lien on property of the estate already encumbered by a lien and afforded a superpriority administrative expense claim.<sup>3</sup> Although the “priming” lien is contingent on a showing that the debtor-in-possession is unable to obtain unsecured or junior lien debtor-in-possession financing, this is not a tough burden to satisfy given that most debtors enter chapter 11 with secured debt well in excess of collateral value. The other requirement — which in theory is much tougher to establish — is that “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.”<sup>4</sup> Although adequate protection is not defined in the Bankruptcy Code, courts generally like to see a significant equity cushion (i.e., the value of prepetition collateral exceeding the face amount of secured debt) of at least twenty percent.<sup>5</sup>

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<sup>2</sup> Michael R. Handler, Arthur J. Steinberg, and W. Austin Jowers, *Pitfalls of Unequal Participation Rights in Syndicated Financing: Is the Juice Worth the Squeeze*, ABI Journal April 2021.

<sup>3</sup> 11 U.S. Code § 364(d).

<sup>4</sup> 11 U.S. Code § 364(d)(1)(B).

<sup>5</sup> *In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293, 306 (Bankr. D. Del. 2011) (citing *In re C.B.G. Ltd.*, 150 B.R. 570, 572 (Bankr.M.D.Pa.1992) (concluding that 14% equity cushion was not sufficient adequate protection to permit debtor to grant super-priority lien in collateral under § 364(d)(1)(B)); *In re McKillips*, 81 B.R. 454, 458 (Bankr.N.D.Ill.1987) (surveying the cases which show that an equity cushion of more than 20% is adequate but less than 11% is not and concluding that equity cushion of 14.5% was inadequate in that case because of the accrual of unpaid taxes and mortgage interest); *In re 1606 New Hampshire Ave. Assocs.*, 85 B.R. 298, 310 (Bankr.E.D.Pa.1998) (concluding that 20% equity cushion was sufficient to establish adequate protection under section 362(d)(1)); *In re Grant Broad. of Philadelphia, Inc.*, 71 B.R. 376, 380 (Bankr.E.D.Pa.1987) (concluding that 27.5% equity cushion, which was increasing, was adequate protection)).

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<sup>1</sup> For an overview of “*Serta* Protection”, see King & Spalding, Private Credit & Special Situations Investing, *Testing for Presence of Serta & NYDJ Risk* available at [www.kslaw.com/attachments/000/008/594/original/What\\_can\\_I\\_do\\_Testing\\_for\\_Presence\\_of\\_Serta\\_and\\_NYDJ\\_Protections.pdf?1613687130](http://www.kslaw.com/attachments/000/008/594/original/What_can_I_do_Testing_for_Presence_of_Serta_and_NYDJ_Protections.pdf?1613687130) and *Drafting Tips to Address Liability Management Transactions* available at [www.kslaw.com/attachments/000/008/305/original/What\\_can\\_I\\_do\\_Drafting\\_Tips\\_to\\_Address\\_Liability\\_Management\\_Transactions.pdf?1611686397](http://www.kslaw.com/attachments/000/008/305/original/What_can_I_do_Drafting_Tips_to_Address_Liability_Management_Transactions.pdf?1611686397).

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Generally speaking, however, where secured creditors have consented to priming, this may obviate the need to show adequate protection.<sup>6</sup> Thus, in a situation where the prepetition secured lenders are funding the proposed DIP financing themselves, they are also consenting to the use of cash collateral and the adequate protection package. To be more precise, most credit agreements vest all decision making and actions with respect to the collateral securing the secured credit facility in the collateral and administrative agent taking direction from the “Required Lenders” (which is typically the lenders holding a simple majority of loans). This effectively gives the lender or lenders controlling “Required Lenders” with significant leverage to negotiate the terms of the proposed DIP financing, because in most situations they are the “only game in town” so to speak (and may leave individual creditors without standing to object to the proposed DIP on the basis of lack of adequate protection).<sup>7</sup> The Controlling Lenders will not consent to be primed by a third-party lender (or incumbent junior lender), and the debtor is typically not incentivized to get into contentious litigation with its senior secured lenders over adequate protection. Even if there is a strong case that there is an equity cushion and third-party financing could be viable, the debtor is likely to prefer DIP financing from the Controlling Lenders as part of a package presenting a path to a going concern exit via a confirmable chapter 11 plan or stalking horse credit bid. Further, this effectively neuters the viability of Minority Creditors to successfully oppose a non-pro rata DIP by proposing an alternative priming or pari

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<sup>6</sup> See, e.g., *Contrarian Funds LLC v. Aretex LLC (In re WestPoint Stevens, Inc.)*, 600 F.3d 231, 261 (2d Cir. 2010) (recognizing the ability of secured creditors to waive adequate protection); *Harvis Trien & Beck, P.C. v. Fed. Home Loan Mortg. Corp. (In re Blackwood Assocs., L.P.)*, 153 F.3d 61, 68 (2d Cir. 1998) (stating that the Code establishes that a secured creditor’s interest may be diminished without adequate protection to the extent the secured creditor waives its right to the protections afforded by the Bankruptcy Code); *RCD Invs. No. 4, Ltd. v. Foothill Cap. Corp. (In re GDH Int’l, Inc.)*, No. 00-45647-BJH-11, Adv. No. 00-4185, 2001 Bankr. LEXIS 2230, at \*11-\*12, \*19 (Bankr. N.D. Tex. Apr. 2, 2001) (stating that where the secured party waived their right to seek adequate protection, no adequate protection finding was required to approve postpetition financing under section 364(d)(1)).

<sup>7</sup> Transcript of Hearing Before the Honorable Christopher S. Sontchi United States Bankruptcy Judge at 64, *In re Premiere International Holdings, Inc.*, Case No. 09-120190 (CSS) (Bankr. D. Del. June 26, 2009) (Docket No. 112) (ruling that lenders vested agent at direction of “Required Lenders” authority to consent to use of cash collateral over objection of individual lender).

passu DIP. If Minority Creditors do not participate in the DIP financing, at best they get primed by the principal amount of new money DIP plus interest and fees (which can be substantial). At worst, they are exposed to one or more economic “parade of horrors” that can further reduce — if not obliterate — their recovery:

- A roll-up of prepetition term loans held by the DIP lenders, which can result in being primed (i.e., subordinated) by not just the new money DIP, but of the roll-up of multiple dollars of prepetition secured debt for every dollar of new money funded by the DIP lenders;
- The Controlling Creditors could credit bid both the prepetition secured loans and the DIP loans and have the DIP loans convert into extremely dilutive preferred stock or just allocate substantially all of the reorganized equity value on account of the DIP loans even if the prepetition term loans are also credit bid, as the Controlling Creditors will dictate the terms of the acquisition vehicle’s capital structure (in other words, the Controlling Creditors will essentially “gift” additional value in respect of the DIP loans, which will increase their blended recovery at the expense of the Minority Creditors that do not hold any DIP loans or hold less than their pro rata share);
- The Controlling Creditors could sponsor a plan of reorganization whereby either they (1) convert the DIP loans into reorganized equity or (2) exchange the DIP for an exit term loan and receive an additional fee in the form of additional exit term loans or equity as consideration for agreeing to roll the DIP into an exit facility, all of which will substantially dilute the equity or other form of recovery received by the Minority Creditors in satisfaction of their prepetition term loans.<sup>8</sup>

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<sup>8</sup> For example, in the *Ascena Retail* chapter 11 cases, the proposed a DIP with a 1:1 roll-up and a fee paid in consideration of the DIP lenders rolling the DIP loans into an exit facility of 45% of the common stock in the reorganized debtors (among other economic consideration). The ad hoc group only offered 50% of the DIP commitments to minority lenders, which they eventually increased for certain members as part of a confidential settlement to resolve the threatened objection of a minority ad hoc group (represented by the author). *In re Ascena Retail Grp. Inc., Case No. 20-33113 (Bankr. E.D. Va.) (KRH)*, *Debtors’ Motion for Entry of Final Orders (1) Authorizing the Debtors to Obtain Post-Petition Financing, (2) Authorizing the Debtors to Use Cash Collateral, (3) Granting Liens and*

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In a 363 or plan sale process scenario where a credit bid is contemplated, the Controlling Lenders could credit bid just the DIP loans — especially if they roll up a substantial part of the prepetition term loans, in which case the Minority Creditors excluded from participating could potentially not receive *any* recovery. Yes, you read that correctly — zero recovery. As discussed below, excluded Minority Creditors in *American Tire Distributors* faced this exact prospect.

## DIP FINANCING PARTICIPATION DISPUTES

Limited bankruptcy court rulings underscore that some courts may be reluctant to condition approval of a DIP financing on Minority Creditors being able to participate in their pro rata share, even if the terms of the DIP and framework of the chapter 11 cases would result in significant disparate recoveries for participating Controlling Creditors and non-participating or under-participating Minority Creditors that were otherwise completely equal and fungible as of the petition date. In the *American Tire Distributors* chapter 11 cases, an ad hoc group of prepetition term loan lenders holding approximately 90% of the prepetition term loans (and also 100% of the ABL FILO loans) structured a \$250 million new money DIP that intentionally excluded most minority prepetition term lenders from having a participation right notwithstanding the repeated requests of the debtors’ professionals that they do so as part of the DIP loan negotiations.<sup>9</sup> Among other things, the proposed \$250 million of new money DIP commitments were conditioned on the roll-up of three dollars of prepetition term debt and the entirety of more than \$100 million of ABL FILO debt. Absent pro rata participation, the recovery of the minority term loan lenders would be obliterated as a result of getting primed by \$1.23 billion of DIP loans (i.e., the roll-up DIP Loans and the new money DIP loans). However, exclusion of the minority lenders from pro rata participation would only boost the majority term loan lenders’ recoveries by

a few percentage points (as there was only so much value to strip from less than 10% of the loans).

An ad hoc group of certain minority term loan lenders — represented by the author of this article — filed a compelling limited objection.<sup>10</sup> The crux of the objection was that as a result of the economic terms of the DIP, including the roll-up, approval of the proposed DIP would be extremely unfair and inequitable unless the minor term loan lenders were able to participate in their pro rata share of the DIP commitments. The objection also pointed out that the economics associated with participating in the DIP commitments could not be determined at the time of the final DIP hearing because the ad hoc group would set the initial credit bid purchase price after the DIP was approved on a final basis (as they would constitute “Required Lenders” even after giving effect to the roll-up). Thus, the ad hoc group could credit bid just the new money DIP loans and the roll-up DIP loans, which would leave the minority lenders with no recovery unless there was a cash overbid from a third-party purchaser that cleared the roll-up DIP loans and the new money DIP loans.

The objection also asserted that the roll-up of the prepetition term loans was in breach of the prepetition term loan credit agreement, which prohibited non-pro rata purchases while the Borrower had an outstanding event of default (as it did as a result of the chapter 11 filing). Notably, the *American Tire Distributors* prepetition term loan credit agreement had robust “Serta protection” protecting minority lenders from the Required Lenders consenting to and funding a priming loan that was not offered to the minority prepetition term lenders on a pro rata basis.<sup>11</sup> However, the *American Tire Distributors* prepetition credit agreement had a carve-out from the Serta protection for debtor-in-possession financing (i.e., “Required Lenders” could consent to, and fund, debtor-in-possession financing without offering it to the minority prepetition term lenders).

After an evidentiary trial, the Bankruptcy Court ruled from the bench. The Bankruptcy Court noted that it was “inclined to believe” that the roll-up was a breach of the prepetition term loan credit agreement and that if the court approves the roll-up, “the minority lenders will sue, and that they will win, and that they will be entitled to damages that will — that they would suffer on

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*footnote continued from previous page...*

*Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection to the PrePetition Lenders, (5) Modifying the Automatic Stay, (6) Scheduling a Final Hearing, and (7) Granting Related Relief* (Dkt No. 18); see also Dkt. No. 565 (describing settlement embodied in first amendment to Restructuring Support Agreement providing minority ad hoc group of pre-petition lenders with participation rights in DIP financing in connection with their joinder to Restructuring Support Agreement); see also *supra* footnote 2.

<sup>9</sup> *In re American Tire Distributors Inc.*, 24-12391 (CTG), (Bankr. D. Del. Oct. 23, 2024) [Doc. 16].

<sup>10</sup> *In re American Tire Distributors Inc.*, 24-12391 (CTG), (Bankr. D. Del. Nov. 12, 2024) [Doc. 186].

<sup>11</sup> *Id.* at ¶ 30.

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account of the breach.”<sup>12</sup> The Bankruptcy Court further noted that if the ad hoc group and Debtors proceeded with DIP as it was proposed (i.e., with roll-up), it would remove all findings and protections in the DIP order so as to preserve the minority lenders’ breach-of-contract lawsuit.<sup>13</sup>

However, the Bankruptcy Court declined to condition approval of the DIP on requiring the ad hoc group to allow the minority term lenders to participate. The Bankruptcy Court explained that the proposed DIP was within the Debtors “reasoned exercise of business judgment” and that while it would prefer a different deal, it does not view its job as “tilt[ing] the leverage” in favor of the minority lenders and “blue pencil[ing]” certain terms of the DIP.<sup>14</sup> The Court concluded that its “way of thinking is that the work of protecting yourself against [non participation] is done by contract, not by bankruptcy law.”<sup>15</sup>

Although *American Tire Distributors* is perhaps the first decision directly on point with respect to minority lender DIP participation rights, it is not the only time the issue has been before a bankruptcy court. For example, in *Nielsen & Bainbridge, LLC* (a/k/a NBG Homes) chapter 11 cases, the U.S. Bankruptcy Court for the Southern District of Texas overruled an individual lender’s objection to the proposed DIP financing funded and structured by the majority lenders (holding just over 50% of the term loans) on the grounds that, among other things, the proposed DIP loan’s one-to-one roll-up was not fair given that the DIP loan was not offered to all lenders, and that it would result in potentially no recovery to the minority lenders unless there was an overbid that cleared the DIP (which was a relatively high hurdle).<sup>16</sup> While the Bankruptcy Court did not address the fairness of the roll-up as a result of the DIP not being offered to minority lenders (as that issue did not appear

to be of significant focus of the objecting party), it found that the DIP was fair and reasonable and within the debtors’ business judgment.<sup>17</sup> Notably, the objecting financing party also put forth a competing DIP, which the debtors viewed as “not actionable” since it would result in a priming fight.<sup>18</sup>

While the limited case law on the issue of DIP participation rights by no means settles the issue of whether bankruptcy law itself could require minority (or pari passu) lender participation in a DIP on the basis that excluding such lenders would render DIP unreasonable and unfair (and, if there is a roll-up component, cause such DIP to fail the “heightened scrutiny” standard for approval of roll-ups), lenders and bondholders should contractually protect themselves if possible against exclusion (or even limited participation) from DIP financing structured and provided by incumbent senior secured lenders.

## DIP FINANCING PARTICIPATION AS A CONTRACTUAL RIGHT

The easiest way to ensure participation in a DIP financing structured and backstopped by a majority lender group is to negotiate for a contractual right to participate in the minority lender’s pro rata share of the commitments of such proposed DIP. The best formulation is to expressly include DIP financing in the *Serta* protection (which I will refer to herein, and take credit for coining the term “American Tire protection”). A revised version of the relevant *Serta* priming financing sacred right in the *American Tire Distributors* prepetition credit agreement is a good place to start.

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<sup>17</sup> *Id.* at 33:10–23.

<sup>18</sup> *In re: Nielsen & Bainbridge, LLC, et al.*, Case No. 23-90071 (DRJ), *Debtors’ Omnibus Reply in Support of the DIP Motion Bidding Procedures, and Adequacy of the Disclosure Statement* (Dkt. 192), at ¶ 2-3 (“The Debtors’ decision to enter into the Restructuring Support Agreement and seek approval of the DIP Facility is predicated in no small part on the fact that the DIP Lenders represent more than 50% of the aggregate outstanding amounts under the First Lien Credit Agreement, and as the “Required Lenders” have the exclusive power to consensually subordinate the prepetition liens of the First Lien Holders. No one else, not even Black Diamond (which holds only 5.7% of the outstanding amounts under the First Lien Credit Agreement), is willing to provide a junior DIP, and no one else has obtained the “Required Lenders” consent to allow for consensual priming. Therefore, the Debtors, in the exercise of their sound business judgment, concluded that the DIP Facility was, and remains, the only viable option.”).

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<sup>12</sup> *In re American Tire Distributors Inc.*, 24-12391 (CTG), (Bankr. D. Del. Nov. 19, 2024), Hrg. Tr. 111:16–19. But see *In re: Speedcast International Ltd., et al.*, 32242 (MI) (Bankr. S.D. Tx. May 20, 2020), Hr. Tr. 105- 111 (holding that roll up of prepetition loans does not violate pro rata sharing requirement of collateral proceeds waterfall in prepetition credit agreement).

<sup>13</sup> *Id.* at 130:1–5.

<sup>14</sup> *Id.* at 129:6–20.

<sup>15</sup> *Id.* at 129:11–15 (emphasis added). Stephen D. Zide and Eric O. Hilmo, “Don’t Tread on Me! Minority Lenders Score a Victory in *American Tire*,” *ABJ Journal* March 2025 provides a more detailed summary of the underlying litigation and decision.

<sup>16</sup> *Id.* at 33:10–23.

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“(h) (i) except to the extent the opportunity to participate as a consenting Lender in any applicable amendment pursuant to which such provisions are so modified has been offered on an equal and ratable basis to all existing Lenders, amend Section 2.12(a), 2.13 or 8.04 in a manner that would alter the pro rata sharing of payments thereunder or (ii) except to the extent an opportunity to participate in the applicable “priming” debt (*including, for the avoidance of doubt, debtor-in-possession financing or similar financing under applicable law*) has been offered to all existing Lenders on a pro rata basis, modifications that subordinating any of the Obligations to any other Indebtedness or subordinating the Liens securing the Obligations to the Liens securing any other Indebtedness (in each case of the foregoing, except ~~(x)~~ Indebtedness that is permitted under this Agreement (as in effect on the Closing Date) to be senior in right of payment to the Obligations and/or be secured by a Lien on the Collateral that is senior to the Lien securing the Obligations, as applicable ~~or~~ ~~(y) in connection with any “debtor-in-possession” facility (or similar financing under applicable law)~~), in each case without the written consent of each Lender directly and adversely affected thereby.”

While there is a “compromise” formulation whereby debtor-in-possession financing is carved out of *Serta* protection if it contains a roll-up,<sup>19</sup> there are too many ways a DIP loan can dilute non-participating Minority Creditors even without a roll-up as discussed above. Further, some American Tire protection formulations expressly carve out “backstop” or “structuring” fees, whereas otherwise expressly require that Minority Creditors be given the opportunity to participate in their pro rata share of such fees.

To the extent the lender has a seat at the table in negotiating the *Serta* protection, the lender should aggressively push back if the sponsor tries to carve out

DIP financing from *Serta* protection. Talking points with the sponsor (and other lenders) may include the following:

- American Tire protection is purely an intercreditor issue, as it has no impact on actual terms of the DIP negotiated and provided by the prepetition term lenders; it just ensures that Minority Creditors will have the opportunity to participate in whatever DIP the Majority Creditors and borrower agree on;
- American Tire protection will reduce the risk of intercreditor litigation and associated costs attendant with a non-pro rata DIP, which is in the best interests of the borrower as a debtor-in-possession;
- American Tire protection has no impact on the sponsor itself (wearing its equity hat), as the sponsor will likely have no economic interests in the borrower once it is in chapter 11, and instead will be focused on a smooth path to exit and obtaining releases (which this provision arguably facilitates).

The sponsor may argue that this provision could “drive up” the cost of DIP financing capital by eliminating competition among lenders to provide DIP financing. However, as discussed above, in most cases the only viable DIP lenders will be the incumbent lenders controlling “Required Lenders.” Moreover, in a private credit deal, “Required Lenders” will likely already be established, and in a broadly syndicated deal the lenders will likely already be subject to a cooperation agreement, eliminating competition among the lenders to form a Required Lender group and propose a DIP loan. In a syndicated deal, there will likely not be fluidity with respect to which lenders constitute “Required Lenders,” as that will be locked down by a cooperation agreement.<sup>20</sup> Even if there isn’t a cooperation agreement, the lenders constituting “Required Lenders” will likely not change in the context of the borrower soliciting DIP financing proposals.

## FOR PRIVATE CREDIT LENDERS

As I have previously written about, private credit lenders have been less exposed to LMEs and, more

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<sup>19</sup> Randall L. Klein, Goldberg Kohn Case Alert, “Lender Liability Management: DIP Financings and the Non-Ratable Roll-Up” (In 2022, when parties first started to draft these exceptions, a thoughtful credit agreement excluded DIP financing from the new *Serta* language, but only if that DIP financing did not include any roll-up. (*Dave & Busters*). Other lenders followed suit and pressed for this roll-up exclusion to the *Serta* DIP exception”).

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<sup>20</sup> A cooperation agreement is an agreement, popular among broadly syndicated lenders, whereby the lenders party thereto agree to generally work together as members of an ad hoc group in connection with a potential LME or other alternative transaction, subject to various covenants.

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specifically, non-pro rata LMEs.<sup>21</sup> However, as private credit deals get bigger and look more like syndicated deals in a number of unaffiliated lenders, a non-pro rata LME or other financing transaction may become more likely. Further, whereas private credit lenders may have relationships with each other and be more inclined not to take advantage of each other using the “Required Lender” leverage, negotiating for a contractual right to participate in DIP financing should be a relatively easy ask at the time of loan origination (especially if the lenders are already getting *Serta* protection). Further, the lenders can negotiate for a DIP participation formulation that ensures all lenders will be treated equally (i.e., pro rata participation, same fees, etc). Your friendly private credit lender may consider that it is being fair by offering the minority lenders 50% of its pro rata share of DIP commitments; why leave it to chance? Finally, if a lender is unable to obtain American Tire protection in the credit agreement, lenders could also negotiate for American Tire protection amongst themselves via a side letter.

#### FOR BROADLY SYNDICATED LENDERS

Unlike private credit lenders, broadly syndicated lenders may not have a seat at the table with respect to negotiating loan documentation at origination. However, this may change if there is a subsequent amendment in which the borrower is soliciting the consent of all lenders. If there is an LME transaction whereby the loan documents are being amended to effectuate new financing, adding American Tire

protection could be an important deal point. Note that this should be a focus of the lenders within the “Cooperation Group,” as being a member of the Required Lender group today may not mean the lender is a member of the Required Lender group should the Company subsequently file for chapter 11 at a later point in time.<sup>22</sup> Minority lenders should also consider DIP financing participation rights if they have the opportunity to negotiate a “stage 2” LME transaction (i.e., when the sponsor and borrower seek minority/non-Cooperation Agreement lenders’ consent to the non-pro rata LME transaction already effectuated with the Required Lender group).

#### CONCLUSION

In one of my favorite scenes of *The Sopranos*, Carmela is having her first (and last) session with her therapist. He tells her, in the context of advising her to leave Tony, “one thing you can never say [is that] you haven’t been told.” Well, while I am not one to analogize “lender on lender” violence to the Soprano crime family (or glorified crew, depending on who you ask), but consider this article fair warning that (1) if the loan agreement does not contain American Tire protection, there is a risk of a non-pro rata DIP financing and (2) the economic consequences to lender recoveries could be disastrous if Controlling Creditors pursue and consummate such a DIP financing. Finally, protecting against a DIP roll-up is not enough, as there is plenty of “technology” to shift value to Controlling Lenders from Minority Creditors without a roll-up as set forth herein. ■

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<sup>21</sup> Michael R. Handler, “Private Credit Restructuring: Less Cost and Volatility; More Optionality”, ABA Business Law Today, July 2024.

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<sup>22</sup> For example, in the *Hearthside Foods* chapter 11 cases, there was an Ad Hoc Group and certain members of the Ad Hoc Group formed a steering committee. The members of the steering committee obtained the exclusive right to participate in 35% of the rights offering, whereas the remaining first lien lenders (including the members of the Ad Hoc Group that were not part of the steering committee) could only participate ratably with all first lien lenders (including the members of the steering committee) in 65% of the rights offering. This underscores that even if a lender is a member of ad hoc group, it still may be subject to unequal treatment as compared to other members of the group. *In re H-Food Holdings, LLC, et al.*, First Day Declaration at Dkt. No. 30 (S.D.Tx. Bankr. 2024).

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