# Private Credit Restructuring: Priming DIPs in Focus

**March 21, 2025**

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

**Priming DIPs Generally**

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

**Unpacking "Adequate Protection"**

"Adequate protection" is intended to protect a pre-petition secured lender from any erosion of its interest in collateral. As Congress explained, the purpose of adequate protection is to ensure that secured creditors are not "deprived of the benefit of their bargain." *See* H.R. Rep. No. 95-595 (1977). Adequate protection is rooted in the Fifth Amendment of the United States Constitution, which protects property owners from a taking without just consideration. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 339 (1977) ("The concept is derived from the fifth amendment protection of property interests."). Adequate protection is intended to protect and compensate a secured party's constitutional right to have the value of its interest in its collateral, as it existed on the date of the bankruptcy filing, preserved. *See United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 370 (1988). As a result, adequate protection "should as nearly as possible under the circumstances of the case provide the creditor with the value of his bargained for rights." *In re Swedeland Dev. Grp., Inc.*, 16 F.3d 552, 564 (3d Cir. 1994) (en banc). "Whether protection is adequate depends directly on how effectively it compensates the secured creditor for loss of value" caused by the debtor's use, sale, or lease of the property in which the creditor has an interest. *Id.* (citation and quotation omitted). This is not an easy burden to satisfy. The standard is exacting and demanding – evidence of the adequate protection must be concrete. "Congress did not contemplate that a creditor could find its priority position eroded and, as compensation for the erosion, be offered an opportunity to recoup dependent upon the success of a business with inherently risky prospects." *Id.* at 567; *see also In re Mosello*, 195 B.R. 277, 292 (Bankr. S.D.N.Y. 1996) ("A finding of adequate protection should be premised on facts, or on projections grounded on a firm evidentiary basis.").

The Bankruptcy Code does not define adequate protection, but Section 361 of the Bankruptcy Code provides three non-exclusive means of providing adequate protection: (1) periodic cash payments to the extent of any decrease in collateral value; (2) an additional or replacement lien to the extent of any decrease in collateral value; or (3) any other relief that provides the secured lender with the "indubitable equivalent" of its interest in the collateral.   Adequate protection in the form of periodic cash payments is typically unavailable due to liquidity constraints. Similarly, additional or replacement liens are typically not an option when, as is common, the existing lender already has liens on substantially all assets. *See, e.g.*, *Swedeland.,* 16 F.3d at 564-65 ("We are at a total loss to understand how a court can suggest that a pre-petition creditor with a lien being subordinated to a superpriority lien can be thought to have adequate protection because an asset encumbered by its lien will remain so encumbered."); 3 Collier on Bankruptcy ¶ 364.05 (16th ed., 2022) ("Providing a lender with a replacement lien on assets on which it already has a lien is illusory and will not support an adequate protection finding.").

Consequently, debtors try to show adequate protection by arguing that erosion of collateral value caused by priming is protected by an "equity cushion" – the amount by which the collateral value exceeds the amount of the primed secured claim. *See In re YL West 87th Holdings I LLC*, 423 B.R. 421, 441 (Bankr. S.D.N.Y. 2010) ("The exist[ence] of an equity cushion seems to be the preferred test in determining whether priming of a senior lien is appropriate under section 364.") (internal quotations omitted); *Wilmington Trust Co. v. AMR Corp.* (*In re AMR Corp.*), 490 B.R. 470, 478 (S.D.N.Y. 2013) ("[T]he existence of an equity cushion can be sufficient, in and of itself, to constitute adequate protection."). The equity cushion is generally expressed as a percentage of the secured debt to be primed. For example, if the secured claim is $100 million and the collateral is worth $150 million, the equity cushion is $50 million or 50%. Collateral valuation is at the heart of the bankruptcy court's determination of whether there is a sufficient equity cushion. There is no bright-line test for the size of the equity cushion, but courts have generally held a roughly 20% cushion (after giving effect to the incurrence of the DIP Loan) to be sufficient, and anything below 10 percent to be insufficient. *See, e.g.*, *SunTrust Bank v. Den-Mark Const. Inc.*, 406 B.R. 683, 700 (E.D.N.C. 2009) (finding insufficient as adequate protection an equity cushion of approximately 11% and proposed improvements to the collateral); *see also R&J Contractor Servs., LLC v. Vancamp*, 652 B.R. 237, 244 (D. Md. 2023) ("Case law has almost uniformly held that an equity cushion of 20% or more constitutes adequate protection … [and] has almost as uniformly held that an equity cushion under 11% is insufficient to constitute adequate protection.") (quotations omitted).

There is another adequate protection theory that is rarely made and usually unsuccessful.  Under this theory, debtors argue that existing secured lenders are adequately protected when a non-consensual priming DIP loan is the only path to preserve the debtor's going concern value.  The thrust of this argument is that the existing lenders will not suffer diminution in the value of their interest in collateral because the third-party priming facility actually *preserves or enhances* collateral value which would otherwise be lost if the debtor were forced to liquidate. Most lenders argue that this "adequate protection" theory is highly suspect, and often built on a speculative foundation devoid of sufficient evidence to meet the debtor's heavy burden. *See, e.g.*, *SunTrust Bank*, 406 B.R. 683 (E.D.N.C. 2009).

This argument was recently raised in Prospect Medical Holdings' chapter 11 case in Dallas, Texas.  There, the debtor sought approval of a $100 million third-party priming DIP loan.  The debtor argued that the existing lender's alternative self-priming DIP proposal was insufficiently sized to conduct its intended sale process, and the lender was adequately protected because the debtor "expected to have significantly higher recoveries if [Prospect] gains access to the DIP financing [which] provides [Prospect] the funding necessary to pay employees and vendors, and continue their hospital operations while they pursue value-maximizing sale transactions."  The existing secured lender forcefully and credibly objected to being primed, arguing that "the Bankruptcy Code does not allow debtors to prime their secured lenders any time they believe that recoveries will improve if only they can use a creditor's collateral to avoid a liquidity crisis."  The bankruptcy court nonetheless held, at the interim DIP financing hearing, that the proposed adequate protection was temporarily sufficient "for purposes of today." We do not know if the interim ruling would have withstood further scrutiny on a final basis because the parties settled their dispute before the final hearing.

## Conclusion

Incumbent lenders are incentivized and have significant structural advantages to provide DIP financing in a chapter 11 case. While facts matter and not every case is the same, we believe the risk of non-consensual priming is extraordinarily rare, particularly for a secured lender with a valid lien on substantially all assets and no credible evidence of a sizable equity cushion. That said, private credit lenders need to be knowledgeable about these risks because negotiating leverage in an out of court restructuring or in the lead-up to a chapter 11 filing is based upon what each party could realistically expect to win in a chapter 11 case.

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

Related Professionals

- **David M. Hillman**

  Partner

- **Jordan Sazant**

  Associate