My Customer Has Landed "DIP Financing" in Its Chapter 11 Bankruptcy: Can I Safely Resume Doing Business With the Debtor?

What Is Debtor-in-Possession Financing?

Debtor-in-possession financing, also known as DIP financing or a DIP loan, is a loan provided to a Chapter 11 debtor in bankruptcy after the commencement of the bankruptcy (*i.e.*, post-petition), usually secured by liens on substantially all of the company's assets and by a "super priority" administrative expense claim.

If My Customer Is in Chapter 11 but Has DIP Financing, Can I Safely Resume Providing Trade Credit?

DIP financing gives a debtor a source of money to pay for goods and services it receives after it files for bankruptcy. However, just as with a customer's pre-bankruptcy line of credit, the DIP loan only remains available if your customer doesn't default on its terms or the loan hasn't otherwise matured.

Key Issues

- **No Guaranty of Payment.** A DIP loan may provide your Chapter 11 customer with sufficient liquidity to pay its post-petition bills as they come due during the bankruptcy, but there is no guaranty that will be the case. Your customer's ability to borrow under the DIP loan will be subject to its compliance with all terms and conditions of the DIP loan. Moreover, if the reorganization fails and the case converts to a Chapter 7 liquidation, the DIP loan will terminate.
- **Others Are at Head of the Line if Reorganization Fails.** If your Chapter 11 customer defaults on its DIP loan and your post-petition bills, you should expect that the DIP loan will be paid before your post-petition invoices. Likewise, if your Chapter 11 customer has additional secured debts (pre-petition secured bank loans, secured notes, secured tax claims, etc.) and it defaults on your post-petition bills, monies realized from their collateral also will be used first to pay them before you. Because certain professionals in the Chapter 11 case enjoy a "carveout" from the DIP lender's liens and claims, they likewise may be paid ahead of you if your customer's reorganization efforts fail.

- **Budget.** Your Chapter 11 customer's ability to borrow under the DIP loan may be subject to a budget that it agrees upon with its DIP lender. There is no assurance that the budget will be adequate to meet all of the company's post-petition obligations or that the financial and operational assumptions built into the budget will be realized.
- **Termination of DIP Loan Upon Sale of Assets.** Many DIP loans will terminate upon the debtor's sale of substantially all of its assets in bankruptcy. While the debtor should ensure that it retains sufficient funds to pay for the post-petition goods and services it received before closing on that sale (or negotiate for assumption and payment of those bills by the buyer), that isn't always the case. That creates a risk that your customer may end up "administratively insolvent" (*i.e.*, unable to pay all of its post-petition bills) post-sale.

Takeaway

Even if your customer has DIP financing, you should examine the post-petition credit worthiness of your customer just as you would outside of bankruptcy. As an overlay to that, you will want to gain and maintain a sound understanding of what is happening and anticipated in the customer's Chapter 11 case.