Beyond Traditional Financing: Exploring Equity-Linked DIP Strategies in WeWork and Enviva

Skadden

Building on emerging trends, 2024 has seen a continued rise in the use of equity-linked debtor-in-possession (DIP) financing in Chapter 11 cases.

Recent examples from WeWork and Enviva illustrate how stakeholders are leveraging this innovative tool to drive broader reorganization strategies and outcomes rather than as a mechanism solely providing interim financing to fund a debtor's operations during the pendency of its bankruptcy case.

WeWork

Following the filing of several versions of a reorganization plan, the debtors in the WeWork case[1] sought approval for a structured two-part DIP financing arrangement.[2] At the initial hearing, the debtors requested $50 million in interim financing to provide immediate liquidity for business operations during the remainder of the bankruptcy proceedings.

For final approval, the debtors sought, upon the plan's effective date, an additional $400 million in financing through a "Exit DIP New Money Facility." In exchange for this $400 million, the lenders would receive 80% of the new equity in reorganized WeWork.

WeWork co-founder Adam Neumann objected to the DIP financing arrangement, arguing that the debtors were improperly attempting to use Section 364 of the Bankruptcy Code to sanction their entry into a novel facility that was not a loan but rather a disguised $400 million investment of equity capital in the reorganized debtors.

According to Neumann, because this facility was designed to capitalize the reorganized debtors and not fund the bankruptcy estate, it did not meet the criteria for approval of DIP financing under Section 364.

Neumann further argued that the DIP motion should be denied as to the Exit DIP New Money Facility because it was an impermissible *sub rosa* plan of reorganization. He claimed that the centerpiece of the debtors' plan was a sale of reorganized WeWork to an "operating partner," which agreed to cut in certain prepetition secured creditors at a substantial discount to fair value through equitization of the exit piece of the DIP loan.

By locking in this key feature outside the confirmation process and relying solely on the business judgment standard applicable to ordinary DIP financings, Neumann claimed the debtors were improperly utilizing Section 364 to bypass Section 1129's more stringent confirmation requirements.

Judge John Sherwood rejected Neumann's arguments, noting that only the $50 million interim DIP facility was actually up for approval at the initial hearing; access to the remaining $400 million under the Exit DIP New Money Facility was contingent on confirmation of the plan and entry of a final order approving the DIP financing.

Based on testimony from the debtors' financial advisor and lead investment banker, Judge Sherwood deemed the $50 million DIP request necessary and approved it. Regarding the DIP New Money Exit Facility, Judge Sherwood also stated that it did not matter whether it was a sale of equity or a DIP loan converting to equity, as the case had always contemplated a debt-to-equity restructuring since the original restructuring support agreement was filed at the outset of the Chapter 11 cases.

The final DIP hearing to approve the DIP New Money Exit Facility was scheduled for the same time as the confirmation hearing. All objections, including Neumann's, were ultimately resolved before the combined hearing, making it fully uncontested. The court approved WeWork's DIP financing, including the DIP New Money Exit Facility, in its entirety and shortly after also confirmed the plan of reorganization.

Takeaways

WeWork's bankruptcy case highlights the significant role equity-linked DIP financing can play in a debtor's overall restructuring transaction, with 80% of the reorganized equity provided through the DIP arrangement and outside the plan of reorganization. However, the uncontested nature of the hearing, following the resolution of objections, leaves unanswered whether another outcome might have occurred following a contested hearing or even if decided in a different jurisdiction.

Additionally, if the debtors had sought approval of the DIP New Money Exit Facility prior to the plan confirmation hearing, whether or not the court would have granted relief at such time remains an open question.

Enviva

This case[3] introduced a new twist on equity-linked DIP structuring: shareholder participation. The debtors sought approval for a $500 million DIP facility, of which $100 million was allocated for prepetition shareholders who had the right to subscribe during a two-week period to participate in the DIP. The terms of the DIP allowed shareholders to convert their loans into equity in

[1] *In re WeWork, Inc.*, No. 23-19865 (JKS) (Bankr. D.N.J. Nov. 6, 2023).

[2] Early in the bankruptcy, the WeWork debtors also sought and were granted approval to enter into a senior secured, first priority cash collateralized DIP "first out" letter of credit facility and a senior secured, first priority DIP "last out" term loan "C" facility, the proceeds of which were used to fully cash collateralize letters of credit under the DIP letter of credit facility.

[3] *In re Enviva Inc.*, No. 24 – 10453 (BFK) (Bankr. E.D. Va. Mar. 12, 2024).

Beyond Traditional Financing: Exploring Equity-Linked DIP Strategies in WeWork and Enviva

the reorganized company at a discounted rate that had not yet been determined at the time of the final DIP hearing.

Notably, the $100 million shareholder segment was fully backstopped by an ad hoc group of creditors who were party to a restructuring support agreement with the debtors. However, such backstop ultimately was unnecessary, since Enviva's existing shareholders oversubscribed in the syndication process.

Enviva's proposed DIP drew objections, particularly from the Official Committee of Unsecured Creditors (UCC). The UCC argued that the arrangement violated the absolute priority rule, which mandates that creditors must be paid in full before equity holders can receive any value on account of their interests, because participating shareholders who converted their DIP loans into equity at a discount could leapfrog general unsecured creditors.

The UCC's objection also noted that the court should not approve these DIP mechanics absent additional information, including specific details regarding the conversion discount, plan value and percentage of equity to be offered, all of which were undetermined at this point.

Judge Brian Kenney dismissed the UCC's objections at the final DIP hearing, ruling that equity to be distributed to shareholders on account of their participation in the DIP was granted based on new capital contributions by such shareholders, not their preexisting equity stakes. Consequently, he determined that this arrangement did not violate the absolute priority rule.

Judge Kenney also found that the DIP financing was a prudent exercise of Enviva's business judgment and was in the best interests of the debtors' estates.

Takeaways

The final DIP order in *Enviva*, which the UCC has appealed, presents an interesting dynamic in equity-linked DIP structuring and raises questions that may be answered differently in a different jurisdiction (or on appeal).

The fact that the $100 million shareholder segment was fully backstopped by an ad hoc group of creditors raises the question of whether the inclusion of shareholder participation was necessary. Additionally, while Judge Kenney determined that the new capital contributions justified the shareholders' rights, the absence of a market test raises questions about how this approach aligns with the principles established in the *LaSalle* U.S. Supreme Court case.[4]

As of the date of this article, the UCC appeal remains pending.

In Sum

The WeWork and Enviva cases mark a continuing trend in the evolution of equity-linked DIP financing. These cases demonstrate that equity-linked DIP financing is not just growing in popularity but also in creativity with regard to its implementation.

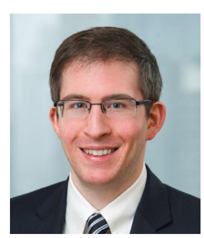
Looking ahead, these financing tools are expected to increasingly play a decisive role in shaping the strategic outcomes of Chapter 11 reorganizations. However, as debtors and lenders continue to test the limits of these innovative structures, courts may also push back on different concepts to ensure adherence to established bankruptcy principles.

[4] *Bank of Am. Nat. Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434 (1999).

Authors

Shana A. Elberg
Partner / New York
shana.elberg@skadden.com

Moshe S. Jacob
Associate / New York
moshe.jacob@skadden.com



Bram A. Strochlic
Associate / New York
bram.strochlic@skadden.com