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Court of Appeals Vacates DIP Financing Order for Lender's Lack of Good Faith

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The Bankruptcy Code encourages lenders to make debtor-in-possession (“DIP”) loans to Chapter 11 debtors. Because of Bankruptcy Code § 364(e), an appeal from a financing order will ordinarily be moot when the lender acted “in good faith” unless the appellant obtains a stay pending appeal. It is hence noteworthy when appellate courts overturn DIP financing orders that were not stayed pending the appeal.

The Fifth Circuit, on September 3, 2014, vacated five bankruptcy court and district court DIP financing orders due to (1) the lender’s lack of good faith in relying on a third party’s shares of stock as collateral; and (2) the bankruptcy court’s lack of subject matter jurisdiction to authorize a lien on third party collateral subject to disputed ownership claims. In re TMT Procurement Corp., 2014 WL 4364894 (5th Cir. Sept. 3, 2014). On October 23, 2014 the Fifth Circuit denied the petition for panel rehearing.

The Fifth Circuit rejected the debtors' argument that the appeals were moot because of the lower courts' repeated findings that the lender had made the loan in good faith. TMT provides a new test regarding the Code's "good faith" requirement for lenders, based on the lender's knowledge of possible insider manipulation of the bankruptcy process. The court also found a lack of subject matter jurisdiction because the debtors' insiders used the bankruptcy financing process to "interfere with" unrelated state court litigation against the debtors' controlling shareholder.

The full version of the article was recently published in *The Bankruptcy Strategist*. It is available online at:

http://www.srz.com/Fifth_Circuit_Vacates_DIP_Financing_Order_for_Lack_of_Good_Faith/

[Link to *Harvard Law School Bankruptcy Roundtable Post*:

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