

# **The Gift of Exit Financing**

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## **ABSTRACT**

Hostile restructurings have spilled over into bankruptcy court and exit financing is often the prize in the center of the arena. Debtors no longer rely upon gifting, the traditional strategy for buying plan support. Instead, they can replicate gifting's benefits by funneling discounted subscription rights to chosen constituencies as part of exit financing.

The strategic use of exit financing has been undertheorized as commentators have focused on rules of thumb and improved monitoring. None recognize the need for market testing. This article (i) explains exit financing's proliferation as a symptom of gifting's demise and an outgrowth of hostile restructurings, (ii) evaluates when exit financings violate the Bankruptcy Code and Supreme Court precedent, and (iii) operationalizes these conclusions to craft a framework for identifying forbidden exit financing gifts.

Unlike gifting, exit financing often provides benefits beyond buying approval for the proposed plan. The proceeds can fund payments required for the debtor to emerge from bankruptcy, while consolidated equity ownership can improve corporate governance. Although parties trumpet these values, exit financing also provides opportunities for gamesmanship akin to gifting. Sophisticated insiders and distressed investors leverage their control of the plan process to obtain sweetheart exit financing deals. The Supreme Court's assessments of new value contributions, a subspecies of exit financing, equip bankruptcy courts with the tools for unmasking exit financing giveaways. Pervasive control can only be separated from the exit financing terms through market testing. Fundamentally, exit financing should be conducted akin to whole-firm asset sales, through market-tested public sales.