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The Yellowstone Club Case: New Concerns Are Raised Regarding Subordination of Secured Creditors Claims

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Background Facts. Timothy Blixseth and his wife formed Yellowstone Mountain Club, LLC (the Debtor), and retained most of the control over the company. Blixseth was approached by a director in Credit Suisse's Investment Banking Division about a new syndicated term loan that allowed Credit Suisse to offer a sizable loan that allowed equity holders to extract distributions for purposes unrelated to the development. Rather than review the Yellowstone Club's audited financial statements prior to issuing the loan, Credit Suisse's financial due diligence consisted of Blixseth's historical and future projections for the development and a non-FIRREA compliant methodology developed by Credit Suisse for its syndicated loan products.

Despite the Club's then-current $20 million debt, Credit Suisse granted the $375 million loan, and in return, received a transaction fee of two percent ($7.5 million). The Loan Agreement authorized a total of $351 million to be used for personal accounts and investments unrelated to the Yellowstone Club. The day the loan was finalized, Blixseth extracted $209 million from Yellowstone Club's account and issued a promissory note to the Club for the same amount. Blixseth never made a demand on the promissory note, even when the Yellowstone Club, persistently behind in its accounts payable, needed the funds.

When the Yellowstone Club filed for bankruptcy, Credit Suisse filed for a $232 million claim. Rather than grant the lender's claim, or even a portion of it, the Court held that the appropriate remedy for Credit Suisse's "overreaching and predatory lending practices in this instance" was equitable subordination of its secured creditor status to that of an unsecured creditor.

Potential Impact on Creditors. The decision in In re Yellowstone Mt. Club, LLC, 2009 Bankr. LEXIS 1158 (Bankr. D. Mont. May 12, 2009), is a warning to creditors that their secured status is not concrete. Equitable subordination is not a common practice in bankruptcy law, but it is not a new trend either. Courts generally honor the status of secured lenders unless and until there is some form of inequitable conduct. [11 U.S.C. § 510(c)(1)] Bank loans that severely jeopardize the borrower's financial viability without benefiting the borrower or engaging in reasoned, thorough due diligence may lose their priority in the event their loan helps lead the borrower to bankruptcy.

Judge Kirscher of the U.S. Bankruptcy Court justified the equitable subordination of Credit Suisse's claim because "the naked greed in this case, combined with Credit Suisse's complete disregard for the Debtors or any other person or entity who was subordinated to Credit's Suisse's first lien position, shocks the conscience of this Court." It appears as though Credit Suisse's punishment was the result of their actions—the Court found that the lenders disregarded whether or not the Yellowstone Club could handle its debt, allowed the Blixseths to extract hundreds of millions of dollars for personal benefit, and made a multi-million dollar profit while the Yellowstone Club spiraled into bankruptcy. [Andrew Ross Sorkin, "Credit Suisse Dressed Down Over Yellowstone Loan," *The New York Times*, DEALBOOK, May 14, 2009 *available at* http://dealbook.blogs.nytimes.com/2009/05/14/credit-suisse-dressed-down-over-yellowstone-loan/] Credit Suisse compromised its secured status because, according the Court, the only plausible rationale for Credit Suisse's actions was the collection of fees it was extracting from the loans it was selling and that qualified as inequitable conduct.

Although some lenders may find Credit Suisse's actions deserving of subordination, the recent decision to subordinate Chrysler's billion dollar senior secured debt in order to aid the company through a "painless bankruptcy" proves that *all* lenders, both unsecured and secured, both reasonable and unreasonable, must now beware. [John Blakeley, "Claims Subordination Becomes Latest Rage," DEALSCAPE, May 14, 2009. *available at* http://www.thedeal.com/dealscape/2009/05/claims_subordination_becomes_l.php#bottom] Senior lenders, including J.P. Morgan Chase, hesitantly accepted about 29 cents on the dollar, close to $2 billion total, for their $7 billion claim. [*Id.*] Additionally, new bankruptcy filings verify that the Chrysler and Yellowstone decisions are not anomalies. Palmdale Hills Property LLC has requested to subordinate its $2.3 billion debt, while MicroIstel Inc. attempted to subordinate its $4 million claim earlier this year. [*Id.*]

The equitable subordination of recent secured creditor claims has forced lenders to question whether they are really protected by bankruptcy law anymore. [Darrell Delamaide, "Chrysler Chapter 11: Brave New World for Secured Lenders," *available at* https://www.cfa.com/eweb/Docs/delamaide_final.pdf] The carelessness of Credit Suisse's actions separated its situation from those creditors who acted responsibly. But the Chrysler decision reinforces that secured lenders really cannot completely rely on their secured status anymore. As one chief executive of a creditor company worried, "the terms of the Chrysler settlement call for secured lenders to be flipped behind or placed on par with unsecured creditors, and that would be precedent-setting." [*Id.*] Using the doctrine of equitable subordination to subordinate secured lenders in bankruptcy filings is a trend that has greatly expanded with these new decisions, causing lenders to have serious concerns over their secured status in bankruptcy.

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